

No. 11146

W. 2435

United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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PACIFIC PUBLIC SERVICE COMPANY,  
a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of the Record


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Upon Petition to Review a Decision of the Tax Court  
of the United States

FILED

NOV 27 1945

PAUL P. O'BRIEN,  
CLERK



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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Hall, Herbert E.

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## APPEARANCES

For Taxpayer:

FELIX T. SMITH, ESQ.,  
SIGVALD NIELSON, ESQ.,  
GRANVILLE S. BORDEN, ESQ.,  
SCOTT C. LAMBERT, ESQ.,

For Comm'r.:

HAROLD D. THOMAS, ESQ.,

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Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,  
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DOCKET ENTRIES

Transferred to Judge Oppen 11/22/44.

1943

Jun. 17—Petition received and filed. Taxpayer notified. Fee paid.

“ 17—Copy of petition served on General Counsel.

“ 17—Request for Circuit hearing in San Francisco filed by taxpayer. 6/17/43 granted.

Jul. 16—Answer filed by General Counsel.

“ 19—Copy of answer served on taxpayer. San Francisco, Calif.

Oct. 14—Hearing set Nov. 22, 1943 at San Francisco, Calif.

1943

Nov. 26—Hearing had before Judge Arundell on merits. Motion of respondent to amend answer and of petition to file amendment to petition. Both motions granted and amendments received. Stipulation of facts filed. Respondent's motion to amend and amendment to answer and petitioner's motion to amend and amendment to petition filed. Respondent's answer to amendment to petition filed. Service made on opposing party of each amendment. Petitioner's brief due Jan. 10, 1944—respondent's 2/9/44—reply 2/29/44.

Dec. 21—Transcript of hearing of 11/26/43 filed.  
1944

Jan. 7—Notice of the appearance of Scott C. Lambert as counsel filed.

“ 12—Motion for extension of 15 days to file brief filed by taxpayer.

“ 12—Order extending time to Jan. 29, 1944 to file petitioner's brief, February 28, 1944 to file respondent's brief and March 19, 1944 to file petitioner's reply brief entered.

“ 27—Order granting petitioner 10 days to file his brief entered. (Tel.)

Feb. 7—Brief filed by taxpayer. 2/7/44 copy served.

Mar. 8—Motion for extension to March 19, 1944 to file respondent's brief filed by General Counsel. 3/10/44 granted.

1944

Mar. 18—Motion for extension to May 19, 1944 to file respondent's brief filed by General Counsel. 3/22/44 granted.

May 11—Motion for extension to July 15, 1944 to file respondent's brief filed by General Counsel. 5/12/44 granted.

Jul. 15—Reply brief filed by General Counsel.

“ 26—Motion for extension to Aug. 15, 1944 to file reply brief filed by taxpayer. 7/26/44 granted.

Aug. 14—Motion for extension of 60 days to file reply brief filed by taxpayer. 8/15/44 granted.

Oct. 12—Reply brief filed by taxpayer. 10/12/44 copy served. [1\*]

“ 12—Motion for leave to file the attached amended petition, amended petition lodged filed by taxpayer. 10/17/44 granted.

“ 12—Motion to reopen record for admission of evidence material since the enactment of the revenue act of 1943 filed by taxpayer. 10/17/44 granted.

“ 12—Supplemental stipulation of facts filed.

“ 17—Copy of motions and amendment to petition served on General Counsel.

Nov. 1—Answer to amendment to petition filed by General Counsel. 11/2/44 copy served.

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\*Page numbering appearing at top of page of original certified Transcript.



1945

Feb. 8—Findings of fact and opinion rendered, Oppen J. Decision will be entered under Rule 50. Copies served.

Mar. 6—Motion for reconsideration and review by the entire court of the opinion rendered, filed by taxpayer. 3/8/45 denied as to reconsideration and 3/8/45 denied as to Court review.

“ 13—Computation of deficiency filed by General Counsel.

“ 17—Hearing set April 18, 1945 on settlement.

Apr. 18—Hearing had before Judge Oppen on settlement under Rule 50. Decision to be entered in accordance with respondent's computation.

“ 20—Decision entered Clarence V. Oppen, Div. 14.

Jul. 20—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

“ 20—Proof of service filed by taxpayer.

Sep. 4—Certified copy of order from U. S. Circuit Court of Appeals, 9th Circuit, extending the time to 9/28/45 to prepare and transmit record filed.

“ 19—Designation of portions of the record to be printed, filed by taxpayer with proof of service thereon.

“ 20—Statement of points filed by taxpayer with proof of service thereon.



1945

Sept. 20—Designation of record filed by taxpayer with proof of service thereon. (Agreed to).

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The Tax Court of the United States

Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IRA: 90-D-C:TS:PD:SE:WGW) HEA dated March 26, 1943, and as a basis of its proceeding alleges as follows:

1. Petitioner is a corporation organized under the laws of the State of California, with its principal office at 225 Bush Street, San Francisco, California. The return for the period involved was filed with the Collector for the First District of California.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on March 26, 1943.

3. The taxes in controversy are income taxes and income defense taxes for 1940 in the sum of \$37,831.36. [3] Of this sum, \$30,488.15 has been paid to the Collector for the First District of California and petitioner has filed a claim for refund of this amount. The balance of the amount in controversy is the deficiency of \$7,343.21 proposed by respondent.

4. The determination of tax set forth in the said deficiency notice is based upon the following errors:

(a) The failure to allow adequate deduction for the loss sustained in the year 1940 by petitioner from the sale by petitioner in 1940 of its bonds and stock of California Consumers Corporation;

(b) The finding that the basis for the bonds and stock of California Consumers Corporation sold by petitioner in 1940 is \$28,757.75;

(c) The holding that petitioner did not receive the bonds and stock of California Consumers Corporation pursuant to a reorganization within the meaning of section 112 (g) of the Revenue Act of 1934 as amended;

(d) The holding that section 112 (b) (5) of the Revenue Act of 1934 as amended is not applicable because the stock and securities received by petitioner are not substantially in proportion to the interest of petitioner in the property prior to the exchange;

(e) The holding that a loss arose from a transaction separate and distinct from and anterior to the exchange of property of California Consumers Company for bonds [4] and stock of California Consumers Corporation and that such loss must be recognized under the general rule of section 112 (a) of the Revenue Act of 1934 as amended.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(A) Facts Relating to the Sale by Petitioner of Its Bonds and Stock of California Consumers Corporation

(1) On September 25, 1940, and on October 7, 1940, petitioner sold to Turner Poindexter and Company of Los Angeles, California, all its bonds and shares of stock of California Consumers Corporation for \$19,654.85 cash.

(2) The bonds of California Consumers Corporation sold by petitioner on September 25, 1940, were bonds in the principal sum of \$75,000, with participating certificate for 600 shares of stock held by voting trustees, and constituted 2.14 plus per cent of the amount of bonds outstanding on the date of sale (the total amount outstanding was in the principal sum of \$3,496,500), and 2.14 plus per cent of the participating certificates outstanding on the date of sale. (The total amount of voting certificates outstanding was 27,972.)

(3) The stock of California Consumers Corporation sold by petitioner on October 7, 1940, consisted

of 4,640.5 shares and constituted 8.55 plus per cent of the total shares outstanding on the date of sale. (The total number of shares outstanding on the date of sale was 54,274 shares, of which [5] 27,972 shares were held by voting trustees.)

(4) In connection with this sale petitioner incurred expenses of \$53.72.

(B) Facts Relating to the Determination of the Basis (Unadjusted) of the Bonds and Stock of California Consumers Corporation Sold by Petitioner in 1940

(1) The bonds and stock of California Consumers Corporation sold by petitioner in the year 1940 were acquired by petitioner in the year 1935 pursuant to a plan of reorganization of California Consumers Company through proceedings confirmed by the United States District Court for the Southern District of California, Central Division, on September 30, 1935, and consummated under the provisions of section 77-B of the Federal Bankruptcy Act.

(2) Pursuant to the terms of the plan of reorganization California Consumers Corporation was organized and thereafter, in 1935, issued bonds in the principal sum of \$3,496,500, and 54,274 shares of stock to bondholders, shareholders, and the unsecured creditor of California Consumers Company.

(3) For each \$1,000 principal amount of bonds, with all appurtenant coupons maturing after Sep-

tember 30, 1933, of California Consumers Company there was issued \$1,000 principal amount of new bonds of California Consumers Corporation, and 8 participating certificates for 8 shares of new stock of California Consumers Corporation. The 8 shares were held by voting trustees. [6]

(4) For each \$500 principal amount of bonds with all appurtenant coupons maturing after September 30, 1933, there was issued \$500 principal amount of new bonds of California Consumers Corporation and 4 participating certificates for 4 shares of new stock of California Consumers Corporation. The 4 shares were held by voting trustees.

(5) For each share of preferred stock of California Consumers Company outstanding with all dividends accumulated and unpaid thereon, there was issued 1.5 shares of new stock of California Consumers Corporation.

(6) To petitioner, as unsecured creditor of California Consumers Company in the amount of \$478,270, there was issued 3,287.5 shares of new stock of California Consumers Corporation.

(7) Petitioner received nothing from California Consumers Corporation for its release of its rights as common stockholder of California Consumers Company.

(8) In the aggregate the exchanges were as follows:



FORMER BONDHOLDERS, UNSECURED CREDITORS AND  
SHAREHOLDERS OF CALIFORNIA CONSUMERS  
COMPANY

Transferred	Received	
	Bonds	Stock
First mortgage bonds in principal amount of \$3,496,500	First mortgage bonds in principal amount of \$3,496,500, and	27,972 participating certificates for 27,972 shares of stock
Preferred stock holders of 15,343 shares—par \$100	None	23,014.5 shares
Unsecured creditor in amount of \$478,270 (owned by petitioner)	None	3,287.5 shares
Common stock, 25,000 (owned by petitioner)	None	None
	Total	Total
	\$3,496,500 bonds	54,274 shares of stock

(9) (a) Petitioner at the time of the reorganization under section 77-B owned bonds of California Consumers Company in the principal sum of \$75,000 with appurtenant coupons maturing after September 30, 1933.

(b) Through the reorganization under section 77-B petitioner's rights in bonds of California Consumers Company in the principal amount of \$75,000 with all appurtenant coupons maturing after September 30, 1933, were modified and altered by the conveyance to the new corporation of the properties free and clear of claims (with certain exceptions) against California Consumers Company and by the issuance of new securities in exchange for such bonds and appurtenant coupons.

(c) Petitioner received, in exchange for this modification and alteration in its rights in bonds of California Consumers Company in the principal amount of [8] \$75,000, together with all appurtenant coupons maturing after September 30, 1933, bonds of California Consumers Corporation in the principal sum of \$75,000 and participating certificates for 600 shares of stock of California Consumers Corporation.

(d) These new bonds of California Consumers Corporation, having a face value of \$75,000, together with the participating certificates for 600 shares, were the bonds and participating certificates which petitioner sold in 1940, as alleged in paragraph 5 (A) (2) above.

(e) The bonds formerly owned by petitioner and by all other bondholders of California Consumers Company were assigned and transferred to California Consumers Corporation, the new company.

(f) Thereafter these bonds were transferred by the new company to the trustee under the trust indenture for the new bonds to be held as additional and collateral security for the new bonds.

(g) The bonds of California Consumers Company in the principal sum of \$75,000 owned by petitioner at the time of the reorganization had been acquired by petitioner at various intervals between April 1, 1931, and July 31, 1933, at a cost of \$54,877.66.

(10) (a) Petitioner, at the time of the reorganization under section 77-B, owned 902 shares of preferred stock of California Consumers Company. [9]

(b) Through the reorganization under section 77-B petitioner's rights in 902 shares of preferred stock of California Consumers Company were modified and altered by the conveyance and transfer to the new corporation of the properties free and clear of all claims (with certain exceptions) against California Consumers Company, its stockholders and creditors, and by the issuance by California Consumers Corporation of new shares in exchange for such preferred shares in California Consumers Company held by them.

(c) Petitioner, through the reorganization, received in exchange for 902 preferred shares of California Consumers Company, 1,353 shares of California Consumers Corporation.

(d) These 1,353 shares of California Consumers Corporation were part of the 4,640.5 shares sold by petitioner in 1940 as alleged above in paragraph 5 (A) (3).

(e) The 902 preferred shares of California Consumers Company owned by petitioner at the date of the reorganization had been acquired by petitioner at various intervals during the years 1931, 1932, and 1933 at a cost of \$51,001.75.

(11) (a) Petitioner, at various intervals prior



to the reorganization, loaned cash to California Consumers Company in the amount of \$478,270.

(b) Petitioner, prior to the reorganization, [10] had never received any cash or other property in payment, in whole or in part, of these loans.

(c) At the date of reorganization this indebtedness of California Consumers Company to petitioner was evidenced by a note dated May 31, 1933, but otherwise petitioner was an unsecured creditor of California Consumers Company in the principal sum of \$478,270.

(d) Through the reorganization under section 77-B in 1935 petitioner's rights as an unsecured creditor of California Consumers Company were altered and modified by the conveyance and transfer to the new corporation of the properties of California Consumers Company to California Consumers Corporation free and clear of all claims (with certain exceptions) against California Consumers Company, its stockholders and creditors, and by the issuance by California Consumers Corporation of 3,287.5 new shares in exchange for petitioner's unsecured claim against California Consumers Company (see paragraph 5 (B) (6) above).

(e) Petitioner has never claimed any portion of the indebtedness of California Consumers Company as partially or wholly worthless in any of its income tax returns.

(f) The 3,287.5 new shares received by petitioner for its unsecured claim of \$478,270 were part

of the 4,640.5 shares sold by petitioner in 1940 as alleged in paragraph 5 (A) (3) above. [11]

(12) The amount and value of the stock and securities of California Consumers Corporation to be received by petitioner (as alleged in paragraphs 5 (B) (9) (c), 5 (B) (10) (c) & 5 (B) (11) (d) above), pursuant to the aforesaid reorganization of California Consumers Company, in exchange for the interests of petitioner in the properties of California Consumers Company prior to such exchange, were fixed and determined as a result of an appraisal by the bondholders' protective committee, preferred stockholders' committee, and petitioner, of the respective interests of the security holders represented by such committees and of the interest of petitioner as an unsecured creditor in the properties of California Consumers Company prior to such exchange, and the amount and value of the stock and securities of California Consumers Corporation received by petitioner as so fixed and determined were substantially in proportion to the interest of petitioner in such properties prior to the exchange; and the amount and value of the stock and securities of California Consumers Corporation received by each and every other person holding an interest in such properties were likewise fixed and determined as a result of the same appraisal and were likewise substantially in proportion to the interests of each and every other of such persons in the properties of California Consumers Company prior to the exchange.

(C) Facts Relating to the Determination of the Adjusted Basis of the Bonds and Stock of California Consumers Corporation Sold by Petitioner in 1940 [12]

(1) During the period petitioner owned preferred or common shares of California Consumers Company it received no distributions from California Consumers Company as distributions of capital.

(2) During the period petitioner owned participating certificates and stock of California Consumers Corporation it received no distributions from California Consumers Corporation either as dividends or as distributions of capital.

(D) Facts Relating to Overpayment of 1940 Income Taxes and Claim for Refund

(1) In 1941 petitioner paid \$30,488.15 to the Collector of Internal Revenue for the First District of California as income taxes for the year 1940 in four equal quarterly installments (March 15, June 15, September 15, and December 15).

(2) On April 22, 1942, petitioner filed a claim for refund with the Collector of Internal Revenue for the First District of California for \$30,488.15, representing all the income taxes paid in the year 1941 for the year 1940.

(3) The facts supporting this claim for refund are the same as the facts alleged in paragraphs 5 (A), 5 (B) and 5 C).

Wherefore, petitioner prays that this Honorable Court may hear the proceedings and order that [13] petitioner sustained and realized a loss of \$564,548.28 in the year 1940 from the sale of bonds and shares of California Consumers Company; that respondent erred in failing to allow this amount as a loss in lieu of \$9,102.90; that petitioner derived no taxable income for the year 1940; that there is no deficiency for 1940; that petitioner overpaid \$30,488.15 income taxes for the year 1940; that petitioner filed claim for refund of such overpayment within two years from the date of such overpayment; that an overpayment of \$30,488.15 shall be refunded or credited to petitioner.

Dated San Francisco, California, June 14, 1943.

FELIX T. SMITH

SIGVALD NIELSON

GRANVILLE S. BORDEN

Attorneys for Petitioner [14]

State of California,

City and County of San Francisco—ss.

H. L. Farrar, being first duly sworn, deposes and says: That he is an officer, to wit, the Vice President of Pacific Public Service Company, a corporation, the petitioner named in the foregoing action, and makes this verification for and on behalf of said corporation; that he has read the foregoing Petition and knows the contents thereof, and that the same is true of his own knowledge, except as to matters therein stated on information or belief,

and as to those matters that he believes it to be true.

H. L. FARRAR

Subscribed and sworn to before me this 14th day of June, 1943.

[Seal]

FRANK L. OWEN

Notary Public in and for the City and County of San Francisco, State of California [15]

EXHIBIT A

SN—IT—1

Treasury Department  
Internal Revenue Service  
74 New Montgomery Street  
San Francisco, California

Office of  
Internal Revenue Agent in Charge  
San Francisco Division

IRA:90-D  
(C:TS:PD  
SF:WGW)  
HEA

Mar. 26, 1943

Pacific Public Service Company  
225 Bush Street  
San Francisco, California

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended De-



cember 31, 1940, discloses a deficiency of \$7,343.21 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner.

By F. M. HARLESS

Internal Revenue Agent in  
Charge.

Enclosures:

Statement.

Form of waiver.

HEA [16]

## Statement

Pacific Public Service Company

225 Bush Street

San Francisco, California

Tax Liability for the Taxable Year Ended December 31, 1940.

	Liability	Assessed	Deficiency
Income Tax	\$37,831.36	\$30,488.15	\$7,343.21

In making this determination of your income tax liability, careful consideration has been given to your protest dated April 8, 1942, and supplement dated July 7, 1942; to the statements made at the conferences held on May 14, 1942, and February 19, 1943, and to your claim for refund filed on April 22, 1942.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issue set forth in your claim for refund should be made a part of the petition to be considered by the Tax Court in any redetermination of your tax liability. If a petition is not filed, the claim for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772(a)(2) of the Internal Revenue Code.

A copy of this letter and statement has been mailed to your representative, Mr. Felix T. Smith, Esq., Standard Oil Building, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you and on file in this office. [17]

## Adjustments to Net Income

Year: 1940

Net income for declared value excess-profits tax computation as disclosed by return .....	\$846,893.02
Unallowable deductions and additional income:	
(a) Net long-term capital loss adjusted.....	83,421.31
	<hr/>
Total.....	\$930,314.33
Nontaxable income and additional deductions:	
(b) Adjustment of capital stock tax accrual.....	7,001.60
	<hr/>
Net income for declared value excess-profits tax computation adjusted .....	\$923,312.73

## Explanation of Adjustments

(a) In the year 1935 you received bonds and stock of California Consumers Corporation, a newly organized corporation, in exchange for your equitable interest in the properties of California Consumers Company, a corporation which had defaulted in the payment of its bonds. The bonds and stock were received pursuant to a 77B proceeding. California Consumers Company was organized in 1928. At that time you acquired its entire common stock and remained the owner of said common stock during the life of the Company. In the interim between 1928 and 1933 you acquired bonds of the Company of a face value of \$75,000.00 at a cost of \$54,877.66. In that period you also acquired 902 shares of preferred stock of said corporation at a cost of \$51,001.75. You had also made advances to said corporation during that period and in 1933 took the corporation's note therefor in the amount



of \$478,270.00. In 1933 you wrote down the above-mentioned items to \$15,001.00. On December 2, 1933 the trustee under the bond indenture securing the bonds filed its bill of complaint for the foreclosure of the indenture in the United States District Court at Los Angeles, and requested the appointment of a receiver of the properties ancillary to and pending the outcome of the foreclosure action. A receiver was appointed who operated the properties up to 1935. Article III of the plan provided in part as follows: [18]

“The properties will be transferred to or acquired by the new corporation free and clear of all claims of the debtor, its stockholders and creditors, except liabilities incurred by the receiver and obligations of the debtor to its subsidiaries and affiliated companies which are to be assumed as provided in Article IX hereof.”

Under the plan of reorganization the bondholders, Pacific Public Service Company, as unsecured creditor, and the preferred stockholders received securities in the new corporation as follows:

Holders of :	Received		
	Bonds (partially income)	Stock	Per Cent of Stock
First Mortgage Bonds (face \$3,496,500)	\$3,496,500.00	27,972 shares	52
Pacific Public Service Company as unse- cured creditor (face \$478,270)	.....	3,287.5 shares	6
Preferred stockholders (15,343 shares par \$100)	.....	23,014.5 shares	42
Common stock (25,000 shares)	.....	.....	....
	<u>\$3,496,500.00</u>	<u>54,274</u>	<u>100</u>

The bonds of the old company provided for interest at 6 per cent per annum and were due in 20 years from 1928. The bonds of the new company provided for interest at 3 per cent per annum payable unconditionally, and an additional 2 per cent per annum to be paid out of income, subject to certain restrictions and the discretion of the board of directors, and if the "income interest" is not earned and available in any annual period it shall not accumulate. The bonds of the new company were dated in 1935 and due in 20 years. The stock issued to the bondholders of the new company was issued to voting trustees under a voting trust agreement to endure for 21 years. In the year 1940 you sold all of the bonds and stock of the new corporation that had been received by you pursuant to the 77B preceeding for \$19,654.85 and claimed a loss of \$92,524.53 upon your return. A summary of the

computation made by you on your return is as follows: [19]

Description	Acquired	Selling Price	Cost	Expense	Loss
75,000.00 bonds	1931-33				
300 shares stock		\$18,750.00	\$ 54,877.66	\$53.72	(\$36,181.38)
,353 shares stock	1931-33	263.82	51,001.75		( 50,737.93)
,287.5 shares stock		641.03	6,246.25		( 5,605.22)
	Totals	\$19,654.85	\$112,125.66	\$53.72	(\$92,524.53)

You now contend that the basis for above-mentioned item (3) should be \$478,270.00. It is held that your basis for all of the above-mentioned stock and bonds which you sold in 1940 is \$28,757.75, producing a loss of \$9,102.90. It is also held that you did not receive the bonds and stock of the new company pursuant to a reorganization within the meaning of section 112(g) of the Revenue Act of 1934, as amended, and, therefore, none of the exceptions under 112(b) of said Act, cited by you, apply. Nor is section 112(b)(5) of said Act, cited by you, applicable because the stock and securities received are not substantially in proportion to the interest in the property prior to the exchange. Even if section 112(b)(5) were applicable, a loss arose from a transaction which was separate and distinct from and anterior to an exchange of property of the old company for the new securities and must be recognized under the general rule of section 112(a) of the Revenue Act of 1934.

(b) You are allowed an additional deduction of \$7,001.60 for capital stock tax, which accrued as of July 1, 1940, computed as follows:

Declared value of your capital stock as shown in the return filed for the year ended June 30, 1941 .....	\$ 8,500,000.00
Tax thereon at \$1.10 per M .....	9,350.00
Add: Defense tax for year 1940 not previously allowed .....	401.60
Total deductible .....	9,751.60
Claimed on return .....	2,750.00
Additional deduction .....	\$ 7,001.60

### Computation of Declared Value Excess-Profits Tax

Net income for declared value excess-profits tax computation .....	\$ 923,312.73
Less:	
10% of \$4,016,603.15, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1940 .....	\$401,660.32
Dividends received credit (85% of \$900,802.38) .....	765,682.02
	1,167,342.34
Balance subject to declared value excess-profits tax .....	None
Total declared value excess-profits and declared value excess-profits defense taxes assessable.....	0.00
Declared value excess-profits tax assessed:	
Original, account No. 411186—First California District .....	0.00
Deficiency (Over-assessment) of declared value excess-profits tax.....	0.00

## Computation of Income Tax

(Corporations with normal tax net incomes of  
\$38,565.89 or more)

Net income for declared value excess-profits tax computation .....	\$923,312.73
Less:	
Declared value excess-profits tax .....	0.00
Adjusted net income .....	\$923,312.73
Less:	
Dividends received credit .....	765,682.02
Normal tax net income .....	\$157,630.71
Income tax (22.1% of \$157,630.71) .....	34,836.38
Income defense tax (1.9% of \$157,630.71, normal tax net income) .....	2,994.98
Total income and income defense taxes assessable.....	\$ 37,831.36
Income tax assessed: Original, account No. 411186, First California District .....	30,488.15
Deficiency of income tax .....	\$ 7,343.21

[Front of Enveloped]

Treasury Department	Penalty for Private Use to
Office of Internal Revenue	Avoid Payment of Post-
Agent in Charge	age, \$300
74 New Montgomery St.	
San Francisco, Calif.	

Official Business [Cancelled Stamp]

[Initials]: CMK

Pacific Public Service Company  
225 Bush Street  
San Francisco, California

[Stamp]: Registered No. 988000

[Stamp]: Received Mar 27 1943 San Francisco

[Stamps reverse side of envelope]:

San Francisco, Calif.	Mar 26, 1943	Reg. Sec.
San Francisco, Calif.	Mar 26 1943	Registered
San Francisco, Calif.	Mar 26 1943	Registered

[Seal]

[Endorsed]: T.C.U.S. Filed June 17, 1943.



[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) to (e), inclusive. Denies that the determination of tax set forth in the notice of deficiency is based upon errors as alleged in subparagraphs (a) to (e), inclusive, of paragraph 4 of the petition. [24]

5. (A)(1) Admits the allegations contained in subparagraph (A) (1) of paragraph 5 of the petition.

(A)(2) For lack of information denies the allegations contained in subparagraph (A)(2) of paragraph 5 of the petition.

(A)(3) For lack of information denies the allegations contained in subparagraph (A)(3) of paragraph 5 of the petition.

(A)(4) For lack of information denies the allegations contained in subparagraph (A)(4) of paragraph 5 of the petition.

(B)(1) Admits the allegations contained in subparagraph (B)(1) of paragraph 5 of the petition.

(B)(2) Admits the allegations contained in subparagraph (B)(2) of paragraph 5 of the petition.

(B)(3) For lack of information denies the allegations contained in subparagraph (B) (3) of paragraph 5 of the petition.

(B)(4) For lack of information denies the allegations contained in subparagraph (B)(4) of paragraph 5 of the petition.

(B)(5) For lack of information denies the allegations contained in subparagraph (B)(5) of paragraph 5 of the petition.

(B)(6) Denies the allegations contained in subparagraph (B)(6) of paragraph 5 of the petition.

(B)(7) Denies the allegations contained in subparagraph (B)(7) of paragraph 5 of the petition.

(B)(8) Denies the allegations contained in subparagraph (B)(8) of paragraph 5 of the petition.

(B)(9)(a) Admits the allegations contained in subparagraph (B)(9)(a) of paragraph 5 of the petition.

(B)(9)(b) For lack of information denies the allegations contained in subparagraph (B)(9)(b) of paragraph 5 of the petition.

(B)(9)(c) Admits the allegations contained in subparagraph (B)(9)(c) of paragraph 5 of the petition.

(B)(9)(d) For lack of information denies the allegations contained in subparagraph (B)(9)(d) of paragraph 5 of the petition.

(B)(9)(e) For lack of information denies the allegations contained in subparagraph (B)(9)(e) of paragraph 5 of the petition.

(B)(9)(f) For lack of information denies the allegations contained in subparagraph (B)(9)(f) of paragraph 5 of the petition.

(B)(9)(g) Admits the allegations contained in subparagraph (B)(9)(g) of paragraph 5 of the petition.

(B)(10)(a) Admits the allegations contained in subparagraph (B)(10)(a) of paragraph 5 of the petition.

(B)(10)(b) For lack of information denies the allegations contained in subparagraph (B)(10)(b) of paragraph 5 of the petition.

(B)(10)(c) For lack of information denies the allegations contained in subparagraph (B)(10)(c) of paragraph 5 of the petition.

(B)(10)(d) For lack of information denies the allegations contained in subparagraph (B)(10)(d) of paragraph 5 of the petition.

(B)(10)(e) Admits the allegations contained in



subparagraph (B)(10)(e) of paragraph 5 of the petition. [26]

(B)(11)(a) For lack of information denies the allegations contained in subparagraph (B)(11)(a) of paragraph 5 of the petition.

(B)(11)(b) For lack of information denies the allegations contained in subparagraph (B)(11)(b) of paragraph 5 of the petition.

(B)(11)(c) Admits the allegations contained in subparagraph (B)(11)(c) of paragraph 5 of the petition.

(B)(11)(d) For lack of information denies the allegations contained in subparagraph (B)(11)(d) of paragraph 5 of the petition.

(B)(11)(e) For lack of information denies the allegations contained in subparagraph (B)(11)(e) of paragraph 5 of the petition.

(B)(11)(f) For lack of information denies the allegations contained in subparagraph (B)(11)(f) of paragraph 5 of the petition.

(B)(12) Denies the allegations contained in subparagraph (B)(12) of paragraph 5 of the petition.

(C)(1) For lack of information denies the allegations contained in subparagraph (C)(1) of paragraph 5 of the petition.

(C)(2) For lack of information denies the allegations contained in subparagraph (C)(2) of paragraph 5 of the petition.

(D)(1) Admits the allegations contained in subparagraph (D)(1) of paragraph 5 of the petition.

(D)(2) Admits the allegations contained in subparagraph (D)(2) of paragraph 5 of the petition.

(D)(3) Denies the allegations contained in subparagraph (D)(3) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

(Signed) J. P. WENCHEL TMM  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Acting Division Counsel.  
T. M. MATHER,  
Special Attorney, Bureau of  
Internal Revenue.

TMM:emb 7/10/43

[Endorsed]: T.C.U.S. Filed July 16, 1943. [28]

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[Title of Tax Court and Cause.]

MOTION FOR LEAVE TO FILE AMENDMENT  
TO PETITION

Comes now the petitioner by its counsel of record and moves this Honorable Court to grant the said

petitioner leave to file the attached amendment to petition in the above entitled cause.

Dated: San Francisco, California, November 20, 1943.

FELIX T. SMITH  
GRANVILLE S. BODEN  
SCOTT C. LAMBERT

Attorneys for Petitioner.

Consent is hereby given to file the above mentioned amendment to petition in the above entitled cause.

.....

[Endorsed]: T.C.U.S. Filed Nov. 26, 1943. [29]

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[Title of Tax Court and Cause.]

AMENDMENT TO PETITION

Petitioner hereby amends its petition filed with The Tax Court of the United States on June 17, 1943, in the above entitled cause in the following respects:

After paragraph 4(e) of the allegations of errors of said petition the following additional paragraph is added:

“4.(f) The failure to allow adequate additional deduction for capital stock tax which accrued as of July 1, 1940.”

After paragraph 5.(D) of the facts upon which petitioner relies in said petition the following additional paragraph is added:

“5.(E) Petitioner filed its capital stock tax return for the fiscal year ended June 30, 1941, with the Collector of Internal Revenue at San Francisco on October 29, 1941. The return disclosed a declared value of \$8,500,000 for its capital stock, upon which a tax liability of \$10,625 was computed at the rate of \$1.25 for each full \$1,000 of declared value. The said tax [30] liability was paid to the Collector of Internal Revenue on October 29, 1941, and no part thereof has been refunded.

In its income tax return for the calendar year 1940, petitioner erroneously claimed as a deduction capital stock taxes for the fiscal year ended June 30, 1941, in the sum of \$2,750 instead of \$10,625. Upon audit of petitioner's income tax return, the Commissioner allowed an additional deduction of \$7,001.60 for the capital stock tax for the fiscal year ended June 30, 1941, computed at the rate of \$1.10 for each \$1,000 as provided by the Revenue Act of 1940 (see Adjustment b, page 4, of the copy of the notice of deficiency). There has accordingly been allowed by the Commissioner capital stock taxes in the total amount of \$9,751.60. A further deduction of \$873.40 should be allowed by the Commissioner.”

Dated: San Francisco, California, November 20, 1943.

FELIX T. SMITH

GRANVILLE S. BORDEN

SCOTT C. LAMBERT

Attorneys for Petitioner. [31]

State of California,

City and County of San Francisco—ss.

B. W. Letcher, being first duly sworn, deposes and says: That he is an officer, to wit, the Secretary of Pacific Public Service Company, a corporation, the petitioner named in the foregoing action, and makes this verification for and on behalf of said corporation; that he has read the foregoing amendment to petition and knows the contents thereof, and that the same is true of his own knowledge, except as to matters therein stated on information or belief, and as to those matters that he believes it to be true.

B. W. LETCHER

Subscribed and sworn to before me this 20th day of November, 1943.

[Seal]

FRANK L. OWEN

Notary Public, in and for the City and County of San Francisco, State of California.

[Endorsed]: T.C.U.S. Filed Nov. 26, 1943. [32]



[Title of Tax Court and Cause.]

ANSWER TO AMENDMENT TO PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amendment to petition in the above proceeding, admits and denies as follows:

4. (f) Admits that the respondent erred in failing to allow adequate additional deduction for capital stock tax which accrued as of July 1, 1940.

5. (E) Admits the allegations contained in paragraph 5 (E) of the amendment to petition.

(Signed) J. P. WENCHEL, H. D. T.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

HAROLD D. THOMAS,

Special Attorney, Bureau of Internal Revenue.

[Endorsed]: T. C. U. S. Filed Nov. 26, 1943. [34]

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[Title of Tax Court and Cause.]

MOTION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P.



Wenchel, Chief Counsel, Bureau of Internal Revenue, and moves for leave to amend the answer to the petition by striking subparagraph (B)(9)(c) of paragraph 5 of the answer heretofore filed and substituting therefor the amendment which is attached hereto.

Wherefore, it is prayed that this motion be granted.

(Signed) J. B. WENCHEL, H. D. T.  
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel.  
HAROLD D. THOMAS,  
Special Attorney, Bureau of  
Internal Revenue.

[Endorsed]: T. C. U. S. Filed Nov. 26, 1943. [34]

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[Title of Tax Court and Cause.]

#### AMENDMENT TO ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and, pursuant to leave first had and obtained, files the following amendment to the answer to the petition in the above-entitled case:

5. (B)(9)(c) Denies the allegations contained in subparagraph (B)(9)(c) of paragraph 5 of the petition.

(Signed) J. B. WENCHEL, H. D. T.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

HAROLD D. THOMAS,

Special Attorney, Bureau of Internal Revenue.

[Endorsed]: T. C. U. S. Filed Nov. 26, 1943. [35]

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[Title of Tax Court and Cause.]

MOTION TO REOPEN RECORD FOR ADMISSION OF EVIDENCE MATERIAL SINCE THE ENACTMENT OF THE REVENUE ACT OF 1943.

Comes now the petitioner by its counsel of record, and respectfully moves this Court to reopen the record in this appeal for the admission of evidence relating to an issue which petitioner seeks to raise by reason of the Revenue Act of 1943, enacted since the hearing of this proceeding.

The issue involved in this appeal is the basis to petitioner of stock and bonds acquired in an insolvency reorganization under Section 77B of the Bankruptcy Act. Said stock and bonds were ac-

quired under the terms of the reorganization in exchange for bonds, preferred stock and a note owned by petitioner in the insolvent corporation, and in consideration of the extinguishment of the common stock of the insolvent corporation, all of which was owned by the petitioner.

Under the law prior to the Revenue Act of 1943 the question of gain or loss on the reorganization exchange and the basis to petitioner of securities received thereunder depended upon whether or not the exchange was in connection with a reorganization as defined in section 112 (g) (1) of the Revenue Act of 1934 or was a transfer to a controlled corporation under section 112 (b) (5) of the Revenue Act of 1934 as interpreted in Supreme Court decisions rendered in 1942.

The Revenue Act of 1943, which was enacted on February 25, 1944, contained in section 121 (b) and (c) new rules for the recognition of gain or loss to and prescribed the basis of share and security holders participating in an insolvent organization. Said new rules as to basis are retroactive to the years involved in this appeal.

Petitioner believes that under section 121 (b) and (c), petitioner's basis in said common stock in said insolvent corporation carried over and became part of the petitioner's stock and securities in the new corporation since under section 121 (b), such common stock was extinguished in consideration of the issuance of stock and securities in the new corporation organized to effectuate such plan of reorganization. Petition claimed no loss in respect of the

common stock under the law prior to the Revenue Act of 1943.

Petitioner has obtained the consent of counsel for respondent to the filing of this motion and to the reopening of the record as respectfully requested herein. [37]

Wherefore petitioner prays that this motion be granted.

Dated San Francisco, California, September 29, 1944.

G. S. BORDEN,  
S. NIELSON,  
SCOTT C. LAMBERT,  
Counsel for Petitioner.

No objection to reopening of the record for the purpose herein stated:

J. P. WENCHEL,  
Chief Counsel, Bureau of Internal Revenue,  
Counsel for Respondent.

[Endorsed]: T. C. U. S. Filed Oct. 12, 1944. [38]

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[Title of Tax Court and Cause.]

### MOTION

Petitioner hereby moves that leave be given to file its amended petition in this proceeding, attached hereto. In support of this motion, petitioner shows as follows:

The Revenue Act of 1943, which was enacted since

the filing of the original petition herein and the hearing of this case, contains new rules for the recognition of gain and loss arising from insolvency reorganizations. Under section 121 (c) of said Revenue Act of 1943 no loss was recognizable to petitioner in the 1935 reorganization of California Consumers Company by reason of the extinguishment of the common stock of said Company owned entirely by petitioner. Petitioner claimed no loss in respect of said common stock under the law prior to the Revenue Act of 1943. Nor did petitioner claim, in its petition herein, that its basis for said stock carried over to the stock and bonds of [39] the newly reorganized corporation sold by the petitioner in 1940.

Petitioner desires to amend its petition herein to add allegations of error and fact relating to its basis for said common stock.

Wherefore, it is prayed that this motion be granted.

Dated San Francisco, California, September 29, 1944.

SIGVALD NIELSON,  
GRANVILLE S. BORDEN,  
SCOTT C. LAMBERT,  
Counsel for Petitioner.

No objection to the granting of the within motion.

J. P. WENCHEL,  
Chief Counsel, Counsel for  
Respondent.

[Endorsed]: T. C. U. S. Filed Oct. 12, 1944. [40]



[Title of Tax Court and Cause.]

### AMENDMENT TO PETITION

The above named petitioner hereby amends its petition herein for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IRA: 90-D-C: TS: PD: SE: WGW) HEA dated March 26, 1923 as follows:

Paragraph 4 is amended to include the following additional assignment of error:

(f) The failure to include in petitioner's basis for its bonds and stock of the California Consumers Corporation sold in 1940, petitioner's basis for the common stock of California Consumers Company extinguished in the 1935 exchange, made pursuant to the plan of reorganization, under which petitioner received stock and bonds of the new California Consumers Corporation.

Subparagraph (B) (7) of paragraph 5 is amended to read as follows: [41]

(7) Petitioner's shares of common stock of the California Consumers Company were extinguished as an essential part of the reorganization under which petitioner received new bonds and new stock of the California Consumers Corporation.

Subparagraph (B) (10) of paragraph 5 is amended by adding after subparagraph (c) the following additional allegations of fact:



(f) Petitioner acquired 15,000 shares of the common stock of California Consumers Company in 1928 in consideration of the issuance of 300,000 shares of class B common stock of petitioner. Petitioner acquired a basis for said common shares of \$6,000, said basis being the basis of the transferors of said common shares of California Consumers Company. During the year 1930 the California Consumers Company increased its outstanding common shares to 25,000 by means of the declaration of a stock dividend of 10,000 shares and charged said dividend against earned surplus at the stated value of \$1.00 per share. Petitioner at the date of the reorganization owned 25,000 shares of common stock of the California Consumers Company for which it had a basis of \$6,000.

Dated September 29, 1944.

Respectfully submitted,

SIGVALD NIELSON

G. S. BORDEN

SCOTT C. LAMBERT

Counsel for Petitioner, [42]

State of California,

City and County of San Francisco—ss.

H. L. Farrar, being first duly sworn, deposes and says: That he is an officer, to wit: Vice President of Pacific Public Service Company, a corporation, the petitioner named in the foregoing action, and makes this verification for and on behalf of said corporation; that he has read the foregoing Amendment to Petition and knows the contents

thereof, and that the same is true of his own knowledge, except as to matters therein stated on information or belief, and as to those matters that he believes it to be true.

H. L. FARRAR

Subscribed and sworn to before me this 5th day of October, 1944.

(Seal)

FRANK L. OWEN

Notary Public in and for the City and County of San Francisco, State of California.

[Endorsed]: T. C. U. S. Filed Oct. 12, 1944. [43]

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[Title of Tax Court and Cause.]

ANSWER TO AMENDMENT TO PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amendment to petition filed by the above-named petitioner admits and denies as follows:

4 (f) Denies that the Commissioner erred in the determination of the deficiency as alleged in subparagraph (f) of paragraph 4 of amendment to petition.

5 (B) (7) Denies the allegations contained in subparagraph (B) (7) of paragraph 5 of amendment to petition.

5 (B) (10) (f) Admits the allegations contained in subparagraph (B) (10) (f) of paragraph 5 of amendment to petition.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

(Signed) J. P. WENCHELL, TMM  
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel;  
T. M. MATHER,  
Special Attorney, Bureau of Internal Revenue.

TMM:b 10/25/44

[Endorsed]: T. C. U. S. Filed Nov. 1, 1944. [44]

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[Title of Tax Court and Cause.]

### STIPULATION OF FACTS

It is mutually stipulated and agreed, by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true in this proceeding without prejudice to the right of either party to offer further evidence not inconsistent with the facts herein stipulated and subject further to the right of either party to object to any of the facts herein stipulated upon the ground of immateriality.

1. On September 25, 1940, and on October 7, 1940, petitioner sold to Turner Poindexter and Company of Los Angeles, all its bonds and shares of stock in California Consumers Corporation for amounts aggregating \$19,654.85 cash. The sales were arm's length transactions between a willing buyer and a willing seller. Since the date of this sale petitioner has not owned any bonds or shares of stock or any other interest in California Consumers Corporation. [45]

2. The amounts received for each, the cost basis claimed, and the loss claimed by petitioner on its return for the taxable year were as follows:

Item	Amount Received	Cost Basis Claimed on Return	Loss Claimed on Return
\$75,000 principal amount of bonds with participating certificates for 600 shares of stock held by voting trustees .....	\$18,750.00	\$54,877.66*	\$36,181.38
1353 shares stock .....	263.82	51,001.75	50,737.93
3287.5 shares stock.....	641.03	6,246.25	5,605.22
Total.....	\$19,654.85	\$112,125.66	\$92,524.53

\* Expense of \$53.72 was also claimed.

In arriving at the cost basis of the 3287.5 shares on the return petitioner used a value of \$1.90 per share.

In the petition, petitioner claims a cost basis of \$478,270.00 (the amount of the note hereinafter referred to) for the 3287.5 shares above referred to.

3. The bonds and stock of the California Consumers Corporation sold by petitioner in the year

1940 were acquired by petitioner in the year 1935 pursuant to an agreement dated March 1, 1935, entitled "Plan of Reorganization of California Consumers Company", a copy of which is attached hereto, marked Exhibit "1-A", and made a part hereof. [46] The plan of reorganization set forth in the agreement dated March 1, 1935, was formulated and proposed by committees representing the bondholders, the preferred stockholders, and the petitioner as unsecured creditor of California Consumers Company. The plan, provisions and terms of this agreement were confirmed by the United States District Court for the Second District of California, Second Division, on September 30, 1935, and carried out and consummated in 1935 under the provisions of Section 77-B of the Federal Bankruptcy Act.

4. All the interested parties accepted the plan. In accordance with the provisions of the plan requiring a new corporation, California Consumers Corporation was organized in 1935, under the laws of the State of California, and, thereafter, in 1935, acquired the properties referred to in said plan which constituted all, or substantially all, the properties which had been owned and operated by California Consumers Company, and issued \$3,496,500 principal amount of bonds and 54,274 shares of stock, as provided in Article III thereof.

The parties who, prior to the said plan, held bonds, stock and note of California Consumers Company, received pursuant to the plan the follow-



ing interests in California Consumers Corporation: [47]

Holdings in California Consumers Company	California Bonds	Interest in Consumers Corporation Common Stock
\$3,496,500 principal amount of bonds (of which \$75,- 000 principal amount were held by petitioner)	\$3,496,500 prin- cipal amount of bonds	27,972 participating certificates for 29, 972 shares of stock
15,343 shares no par value preferred stock (of which 902 shares were held by petitioner)	None	23,014.5 shares
\$478,270 unsecured demand note (held by petitioner)	None	3,287.5 shares
25,000 shares common stock held by petitioner).....	None	None
Totals.....	\$3,496,500 bonds	54,274 shares

No cash or other consideration was paid by California Consumers Corporation to any bondholder, stockholder or noteholder except that specifically provided for in the plan.

5. The California Consumers Company, a Delaware corporation, was organized on March 20, 1928. It operated both directly and indirectly through various subsidiary companies an extensive ice and cold storage business in Southern California. Operations by the California Consumers Company resulted in losses, and in December, 1933, it was insolvent. Excepting liabilities to the subsidiary and affiliated companies, its liabilities at that time were as follows: [48]



\$3,496,500 principal amount First Mortgage Series "A" bonds dated April 2, 1928, of which petitioner held \$75,000 principal amount.

\$478,270 unsecured promissory note, held by petitioner.

At such time it had stock outstanding as follows:

15,343 shares \$7.00 cumulative preferred stock, no par value, of which petitioner held 902 shares.

25,000 shares of no par common stock, held by petitioner.

6. On October 1, 1933, California Consumers Company defaulted in the payment of the semi-annual interest due on said First Mortgage Series "A" bonds. Accordingly, on December 2, 1933, the Security-First National Bank of Los Angeles, the trustee to the indenture securing the bonds of the California Consumers Company, filed a bill of complaint for the foreclosure of the indenture in the United States District Court at Los Angeles, and requested the appointment of a receiver of the properties ancillary to and pending the outcome of the foreclosure action. The court appointed on that day a receiver of the properties, and the properties were, thereafter, until the consummation of the aforesaid agreement dated March 1, 1935, operated by the receiver. [49]

7. In 1928, petitioner acquired 15,000 shares of common stock of the California Consumers Company, which constituted, at that time, all the issued and outstanding shares of common stock. On June

10, 1930, it acquired 10,000 additional shares of common stock by reason of a declaration of a dividend of 10,000 shares on said 15,000 shares. Petitioner thereafter, until the time of the transaction covered by the agreement dated March 1, 1935, held all the issued and outstanding common stock of the California Consumers Company consisting of 25,000 shares.

8. At various intervals between April, 1931, and July, 1933, petitioner acquired a total of 902 shares of preferred stock of the California Consumers Company at a cost of \$51,001.75, and bonds of said Company in the principal amount of \$75,000.00, at a cost of \$54,877.66. Said purchases were made on the open market. Said shares and bonds were held by petitioner up to the time of the transaction covered by the agreement dated March 1, 1935.

9. Prior to May 31, 1933, the petitioner had made cash advances to the California Consumers Company which totaled \$478,270.00. On that date the California Consumers Company made and signed a promissory note (payable on demand and bearing interest at 5% per annum) in the amount of \$478,270.00 in favor of the petitioner, evidencing an indebtedness of that amount. The petitioner, prior to the aforesaid agreement, dated March 1, [50] 1935, had not received any cash or other property in payment in whole or in part of these loans.

10. Subsequent to the acquisition by the petitioner of stock of California Consumers Corporation, no distributions were made by said corporation which would affect the basis for gain or loss upon the sale of such stock in the taxable year.

Without admitting that no distributions from capital were made by California Consumers Company on its preferred stock prior to the agreement dated March 1, 1935, respondent agrees that for the purpose of computing the petitioner's tax liability involved in this proceeding, and for that purpose only, no adjustments to any basis otherwise allowable are to be made for any distributions on preferred stock from said company to petitioner between the time of petitioner's acquisition of preferred stock of said company and the agreement of March 1, 1935. The word "distributions", as used in this paragraph, does not embrace any transactions occasioned by the receivership and the carrying out and the consummating of the agreement dated March 1, 1935.

11. The petitioner has never claimed any portion of the unsecured indebtedness of the California Consumers Company as partially or wholly worthless in any of its income tax returns, nor has petitioner received any tax benefits through bad debt deductions with respect thereto. No part of the petitioner's cost of preferred stock and bonds of the California Consumers Company, or of its common stock and bonds of the California Consumers Corporation, has been claimed or allowed as a [51]

deduction, or otherwise, in any tax return filed by petitioner prior to the year 1940.

Petitioner reported a net loss in its Federal income tax return for each of the calendar years 1933, 1934, and 1935, and no tax has been paid by petitioner for these years.

12. As of December 31, 1933, petitioner wrote down its investment in the bonds of California Consumers Company to \$15,000.00, petitioner's estimate of their fair market value as of December 31, 1933, and wrote down the balance of its investments and note to \$1.00.

13. By reason of its respective holdings of bonds, stock and note of California Consumers Company prior to the carrying out of the plan, petitioner, as the result of the consummation of said plan, dated March 1, 1935, received the following:

Holdings in California Consumers Company	Received holding in California Consumers Corporation
\$75,000.00 principal amount of bonds	\$75,000.00 principal amount of bonds with participating certi- ficates for 600 shares of com- mon stock held by voting trus- tees
902 shares preferred stock	1353 shares of common stock
\$478,270.00 note—unsecured	3287.5 shares of common stock
25,000 shares common stock	Nothing

The bonds and stock of California Consumers Corporation which petitioner received, as stated above, were the bonds and stock which were sold

by petitioner as set forth in paragraphs 1 and 2 hereof.

14. The provisions of the bonds of the California Consumers Corporation are set forth in Article IV of the agreement dated March 1, 1935.

The first and only issue of bonds by California Consumers Company were first mortgage bonds and were designated as the "First Mortgage and First Lien Gold Bonds, Series A". Said bonds were dated April 1, 1928, and, subject to provision for earlier redemption, matured twenty years from said date. Series A bonds outstanding were in the principal amount of \$3,496,500. Interest was due thereon from April 1, 1928, at the rate of 6% per annum, payable semi-annually upon April 1st and October 1st of each year.

The Company reserved the right to redeem the bonds before maturity upon the payment of the principal thereof, plus accrued interest and a premium of 5% for redemption within the first ten years, less  $\frac{1}{2}\%$  per year for redemption within each year after April, 1939.

Said Series A bonds issue obligated the Company to deposit a service charge into a sinking fund for the purchase and/or [53] redemption of Series A bonds. In lieu of making the required sinking fund payment in cash, the Company could, at its option, deposit with the trustee for the sinking



fund, Series A bonds, and receive credit therefor to the extent of the cost of the bonds so surrendered.

SIGVALD NIELSON  
GRANVILLE S. BORDEN  
SCOTT C. LAMBERT

Counsel for Petitioner.

J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

#### EXHIBIT A-1

### PLAN OF REORGANIZATION OF CALIFORNIA CONSUMERS COMPANY

March 1, 1935

Bondholders Protective Committee: W. D. Court-right, Edward L. Eyre, John Earle Jardine, Floyd C. Merritt, Guy Witter. Harry R. Wiley, Secretary, 634 South Spring Street, Los Angeles, California. Telephone VAndike 6111. O'Melveny, Tuller & Myers, 433 South Spring Street, Los Angeles, California. Counsel. Bank of America National Trust and Savings Association, 660 South Spring Street, Los Angeles, California. Depository.

Preferred Stockholders Committee: Garrettson Dulin, Wyatt H. Allen, John Bullard, Herbert E. Hall, Catesby C. Thom. M. K. Pattison, Secretary, 900 California Bank Building, Los Angeles, California. Telephone TRinity 4711. Chandler, Wright & Ward, 210 West Seventh Street, Los Angeles,



Exhibit A-1—(Continued)

California. Counsel. California Trust Company,  
629 South Spring Street, Los Angeles, California.  
Depository. [55]

Approved by Federal Court, September 30, 1945.

Plan of Reorganization for California Consumers  
Company.

Article I.

DEFINITIONS.

When used in this plan, unless the context otherwise requires, the following terms shall have the following meanings:

“Debtor” means California Consumers Company, a Delaware corporation.

“Present bonds” means First Mortgage and First Lien Twenty-Year 6% Gold Bonds, Series A, dated as of April 2, 1928, executed by California Consumers Company.

“Properties” means all property now or hereafter subject to the indenture and/or supplemental indenture, both dated as of April 2, 1928, executed by said California Consumers Company to Los Angeles-First National Trust & Savings Bank as Trustee, for the purpose of securing the present bonds.

“Present indenture” means said indenture of April 2, 1928, as supplemented by said supplemental indenture of the same date.

“Bondholders” means the owners and holders of the present bonds.

## Exhibit A-1—(Continued)

“Bondholders’ agreement” means California Consumers Company Bondholders’ Protective Agreement dated as of May 1, 1934, between W. D. Courtright, Edward L. Eyre, John Earle Jardine, Floyd C. Merritt and Guy Witter as the Committee, and such holders of the present bonds as have and shall become parties thereto as therein provided.

“Bondholders’ committee” means the Committee (as now or hereafter constituted) constituted by and acting under the bondholders’ agreement.

“Preferred stock” means the \$7 cumulative preferred stock, without par value, heretofore issued by California Consumers Company and now outstanding.

“Preferred stockholders” means the owners and holders of the preferred stock.

“Preferred stockholders’ agreement” means California Consumers Company Preferred Stockholders’ Protective Agreement dated as of May 1, 1934, between Garrettson Dulin, Wyatt H. Allen, John Bullard, Herbert E. Hall and Catesby C. Thom as a Committee, and such preferred stockholders as have and shall become parties thereto as therein provided.

“Preferred stockholders’ committee” means the Committee (as now or hereafter constituted) constituted by and acting under the preferred stockholders’ agreement.

“New bonds” means the new bonds to be issued pursuant to this plan.

“New trust indenture” means the indenture to

## Exhibit A-1—(Continued)

be executed pursuant to this plan to secure the new bonds.

“New corporation” means the new corporation which may be formed pursuant to this plan for the purpose of acquiring the properties, issuing the new bonds, executing the new trust indenture and issuing the new stock.

“New stock” means the stock to be issued by the new corporation.

“Voting trustees” means the trustees (including their successors) to whom is to be issued that proportion of the new stock to be issued for the benefit of the bondholders.

“Participating certificates” means certificates to be issued by the voting trustees, pursuant to this plan, representing the new stock to be issued to the voting trustees for the benefit of the bondholders.

“Present trustee” means Security-First National Bank of Los Angeles, a national banking association, or its successor, as trustee under the present indenture.

“Trustee” means the trustee under the new trust indenture.

“Dividend suit” means the suit filed on December 29, 1933, in the Superior Court of the State of [56] California in and for the County of Los Angeles, No. 367553, entitled “Guy L. Goodwin as Receiver and Security-First National Bank of Los Angeles as Trustee, et al., Plaintiffs, vs. Pacific Public Service Company, a corporation, et al.,

## Exhibit A-1—(Continued)

Defendants,” seeking the recovery of the amount of certain dividends alleged to have been illegally declared and paid on both preferred and common stock of California Consumers Company, amounting to the sum of approximately \$1,000,000.

“Section 77B” means Section 77B of the act of July 1, 1898 entitled “An act to establish a uniform system of bankruptcy throughout the United States,” as heretofore or hereafter amended.

“Reorganization proceedings” means the proceedings which may be instituted for a reorganization of the debtor under Section 77B, for the purpose of consummating this plan.

“Court” means the court in the reorganization proceedings, and the “judge” means the judge of said court.

“Reorganization trustee” means the trustee who may be appointed by the judge in the reorganization proceedings.

“Receiver” means Guy L. Goodwin or his successor, as the receiver heretofore appointed by the United States District Court for the Southern District of California, Central Division, in the action entitled “Security-First National Bank of Los Angeles, as Trustee, Plaintiff, vs. California Consumers Company, a corporation, Defendant,” (In Equity No. 122-C) heretofore instituted by the present trustee for the foreclosure of the present indenture.

“Subsidiary companies” means companies all of the outstanding shares of which (except for direc-

## Exhibit A-1—(Continued)

tors' qualifying shares) are owned by California Consumers Company.

"Affiliated companies" means companies (other than subsidiary companies) in the same line of business in which California Consumers Company owns a stock interest.

The term "creditors" shall include for all purposes of the plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such claims would otherwise constitute provable claims under the Federal Bankruptcy Act, and the term "claims" includes debts, securities, other than stock, liens or other interest of whatever character.

## Article II.

## Introductory.

California Consumers Company (herein called "the debtor") owned, and prior to December 2, 1933 operated, both directly and through its various subsidiary companies, an extensive ice and cold storage business in Southern California. Excepting liabilities incurred by the receiver and liabilities to the subsidiary and affiliated companies, the debts and outstanding stock of the debtor are as follows:

\$3,496,500 principal amount of present bonds secured by the present indenture;

An unsecured promissory note or notes in the



## Exhibit A-1—(Continued)

aggregate principal amount of \$478,270.00 held by Pacific Public Service Company;

15,343 shares of preferred stock held by the public generally;

25,000 shares of common stock held (with the possible exception of directors' qualifying shares) by Pacific Public Service Company.

On December 2, 1933, the present trustee filed its bill of complaint for the foreclosure of the present indenture in the United States District Court at Los Angeles, California, and requested the appointment of a receiver of the properties ancillary to and pending the outcome of the foreclosure action. On the same day the Honorable Wm. P. James, judge of said court, appointed Guy L. Goodwin receiver of the properties, and the properties was thereafter operated and are still being operated by said receiver.

The plan now proposed has been prepared by the bondholders' committee and the preferred stockholders' committee and has been agreed to by Pacific Public Service Company and the debtor. It contemplates a reorganization to be consummated through proceedings under Section 77B. Upon approval of the plan by the holders of at least two-thirds in principal amount of the present bonds, a reorganization proceeding under Section 77B will be instituted by the debtor for the purpose of consummating the plan, subject to its confirmation by the court in the reorganization proceedings. If for any reason it shall become necessary or desir-



## Exhibit A-1—(Continued)

able, in the judgment of the bondholders' committee, that the plan be carried out otherwise than in such reorganization proceedings, then the plan shall be carried into effect in such manner as to accomplish independently of the reorganization proceedings substantially similar results for the bondholders and preferred stockholders participating in the plan.

Except as otherwise expressly stated, the provisions herein contained have been prepared in contemplation of carrying the plan into effect in the reorganization proceedings; and so long as substantially similar results are obtained for bondholders and preferred stockholders participating in the plan, no amendment or modification of the plan made necessary or desirable in order to carry it into [57] effect otherwise than in the reorganization proceedings shall be deemed to affect adversely the bondholders or the preferred stockholders or to confer on such holders any right to withdraw from the plan.

## ARTICLE III.

## THE PLAN IN GENERAL.

## New Corporation to Acquire Properties.

The properties will be transferred to or acquired by the new corporation free and clear of all claims of the debtor, its stockholders and creditors, except liabilities incurred by the receiver and obligations of the debtor to its subsidiaries and affiliated companies which are to be assumed as provided in

## Exhibit A-1—(Continued)

Article IX hereof. The new corporation will have the following capitalization:

\$3,496,500.00 principal amount of new bonds (described in Article IV below):

54,274 shares of new stock to be presently issued and to be divided between the bondholders,

Pacific Public Service Company, and preferred stockholders' as follows:

Bondholders—27,972 shares (or approximately 52% of all of the new stock to be issued), to be represented by participating certificates issued under the voting trust agreement described in Article V below.

Pacific Public Service Company—3,287.5 shares (or approximately 6% of all of the new stock to be issued).

Preferred stockholders—23,014.5 shares (or approximately 42% of all of the new stock to be issued).

Treatment of Existing Security Holders and  
Creditors.

Bondholders. The rights of the bondholders shall be modified and altered by the conveyance and transfer to the new corporation of the properties free and clear of all claims (with the aforementioned exceptions) of the debtor, its stockholders and creditors, and by the issuance by the new corporation of new securities in exchange for the bonds held by them, as follows:

For each \$1,000, principal amount, of present

Exhibit A-1—(Continued)

bonds with all appurtenant coupons maturing on and after October 1, 1933—\$1,000, principal amount, of new bonds; and Participating certificates for 8 shares of new stock.

For each \$500, principal amount, of present bonds with all appurtenant coupons maturing on and after October 1, 1933—\$500, principal amount, of new bonds; and Participating certificates for 4 shares of new stock.

If the plan is carried into effect in the reorganization proceedings, it will not become effective unless and until it shall have been accepted in the manner provided in Section 77B by or on behalf of the holders of two-thirds in amount of the present bonds and confirmed by the court, but upon such confirmation it shall be binding upon all holders of the present bonds, including those who have not, as well as those who have, accepted it.

Upon consummation of the plan, all rights of the holders of the present bonds (except the right to receive the new securities) and all coupons appurtenant to said bonds, shall pass to the new corporation. The present bonds will be assigned and transferred to the new corporation and by it to the trustee under the new trust indenture, to be held as additional and collateral security for the new bonds.

Unsecured Creditors. The rights of Pacific Public Service Company, as an unsecured creditor of the debtor, shall be modified and altered by the conveyance and transfer to the new corporation of

## Exhibit A-1—(Continued)

the properties free and clear of all claims (with the aforementioned exceptions) of the debtor, its stockholders and creditors, and by the issuance by the new corporation of 3,287.5 shares of the new stock to Pacific Public Service Company in exchange for its unsecured claim against the debtor. The claims of any unsecured creditors other than Pacific Public Service Company shall not be affected by the plan, within the meaning of Section 77B.

**Preferred Stockholders.** The rights of the preferred stockholders of the debtor shall be modified and altered by the conveyance and transfer to the new corporation of the properties free and clear of all claims (with the aforementioned exceptions) of the debtor, its stockholders and creditors and by the issuance by the new corporation of new securities in exchange for the preferred stock held by them, as follows:

For each share of preferred stock, with all dividends accumulated and unpaid thereon—1.5 shares of new stock.

**Common Stock.** The rights of the common stockholders of the debtor shall be modified and altered by the conveyance and transfer to the new corporation of the properties free and clear of all claims (with the aforementioned exceptions) of the debtor, its stockholders and creditors. No new securities shall be issued to the common stockholders. Pacific Public Service Company, as the holder of all of the outstanding [58] common stock of the debtor



## Exhibit A-1—(Continued)

(except qualifying shares of directors), by accepting this plan shall waive whatever right it might have to claim participation in the plan by virtue of its ownership of the common stock of the debtor.

Disposition of Dividend Suit. The dividend suit shall be dismissed with prejudice to all parties plaintiff therein and such dismissal with prejudice shall be binding upon all bondholders and preferred stockholders of the debtor; any and all other claims of the Receiver and/or bondholders and/or preferred stockholders of the debtor against Pacific Public Service Company shall be released.

If the holders of less than a majority of the preferred stock of the debtor shall accept the plan, then (unless the judge shall determine either that the debtor is insolvent or that the interest of the preferred stockholders will not be affected adversely by the plan), protection for the realization by them of the value of their equity, if any, in the properties shall be provided either by a sale of the properties at not less than a fair upset price to be fixed by the judge, or by appraisal and payment in cash of the value of their preferred stock, or at the objecting preferred stockholders' election, of the new stock allotted to them under the plan, whichever method the judge determines will do substantial justice to such preferred stockholders under and consistent with the circumstances of this particular case.

## Exhibit A-1—(Continued)

## Article IV.

PROVISIONS OF NEW BONDS AND OF  
NEW TRUST INDENTURE.

1. The new bonds shall be dated as of such date as the bondholders' committee shall designate and, subject to provisions for earlier maturity by reason of redemption, acceleration of maturity, or otherwise, shall mature twenty (20) years from their date. The authorized principal amount of the new bonds shall be \$3,496,500.00. The new bonds shall bear interest at the rate of five per cent (5%) per annum, the first payment of interest to be due eight (8) months after the date of the new bonds. Of said interest at the rate of five per cent (5%) per annum, interest at the rate of three per cent (3%) per annum shall be fixed (i.e., unconditionally due) and payable in semiannual installments and the balance of the annual interest shall be payable in annual installments but only if and to the extent that the net income of the new corporation and its subsidiaries on a consolidated basis, as determined by annual audit, for the twelve (12) months period ended two (2) months preceding the annual income interest payment date, is available for the payment of interest. That part of the interest which shall be unconditionally due and payable at the rate of three per cent (3%) per annum, as aforesaid, is hereinafter referred to as "fixed interest" and that part of the interest which is payable only out of such available net income



## Exhibit A-1—(Continued)

is hereinafter referred to as "income interest." Net income shall be deemed to be available for the payment of income interest only if the payment thereof will not reduce the net working capital of the new corporation and its subsidiaries on a consolidated basis, to an amount insufficient for the needs of the business as determined from time to time by the board of directors and, so long as the voting trust agreement is in existence, approved by at least a majority of the voting trustees. The new trust indenture may provide that distributions of income interest to bondholders need be made only in multiples of one-fourth of one per cent ( $\frac{1}{4}$  of 1%) of the principal amount of the outstanding new bonds. Income interest not earned and available as aforesaid in any annual period shall not accumulate.

2. The new bonds shall be secured by a new trust indenture in the nature of a trust deed and/or mortgage and/or chattel mortgage and/or pledge upon all of the properties to be acquired by the new corporation, subject only to the lien of taxes, street bonds and/or assessments not delinquent; any and all leases; easements, conditions, reservations, restrictions, covenants, and rights of way; and other matters, if any, which shall be approved or authorized by the bondholders' committee. Such new trust indenture shall be executed by the new corporation and shall designate such trustee as the bondholders' committee shall select, with such powers, duties, rights, privileges, and immunities

## Exhibit A-1—(Continued)

as shall be provided in the new trust indenture. The trustee shall be such bank or trust company with offices in Los Angeles, California, as may be designated by the bondholders' committee. The trustee shall be entitled to reasonable compensation for its services.

3. The new bonds shall either bear coupons evidencing the fixed and income interest, registerable as to principal only, or if the bondholders' committee shall so determine, shall be registered both as to principal and interest.

4. The new trust indenture shall provide for the establishment of a sinking fund with the trustee thereunder, in which the new corporation shall deposit annually, commencing not later than fourteen (14) months after the date of the new bonds, cash equal to an amount arrived at by adding to one-half ( $\frac{1}{2}$ ) of the consolidated net income of the new corporation and its subsidiaries (computed for sinking fund purposes as hereinafter provided) for the twelve (12) months ending two (2) months preceding such sinking fund payment date, the total amount of the provision for depreciation and obsolescence deducted in computing said net income, and subtracting from such sum the total amount of any expenditures during such twelve (12) months for additions, betterments, renewals and replacements [59] charged to asset or depreciation reserve accounts on the books of the new corporation and/or its subsidiaries, except amounts received from the sale of capital assets and expended

## Exhibit A-1—(Continued)

during such period for additions and/or betterments; provided, however, that to the extent that the board of directors of the new corporation, with the approval, so long as the voting trust agreement is in existence, of a majority of the voting trustees, determines that any such payment would reduce the consolidated net working capital of the new corporation and its subsidiaries to an amount not sufficient for the needs of the business or would impair the ability of the new corporation to provide for reasonably anticipated expenditures for additions, betterments, renewals and/or replacements, no such sinking fund payment shall be required.

In lieu of making any required sinking fund payment in cash, the new corporation may at its option surrender new bonds to the trustee for cancellation, and it shall then be entitled to receive credit on its sinking fund obligations to the extent of its actual cost of the new bonds so surrendered, as certified to the trustee by at least two officers of the new corporation.

The sinking fund payments shall be cumulative only to the extent that any amount computed as above described which is not paid on a sinking fund payment date, because determined as aforesaid to be necessary for working capital and/or additions, betterments, renewals and/or replacements, shall be subsequently paid in full into the sinking fund before any dividends may be declared or paid on the new corporation's outstanding stock.

The amount of the consolidated net income of the

## Exhibit A-1—(Continued)

new corporation and its subsidiaries shall be their net income (excluding profits and losses on disposition of capital assets) computed in accordance with good accounting practice; and without limiting the generality of that expression, such net income shall be computed to sinking fund purposes after deducting:

(a) All current operating expenses in connection with the business, including, in accordance with good accounting practice, provision for reasonable reserves for depreciation and obsolescence, and the payment or provision for all taxes and assessments (including but not limited to general taxes, income and franchise taxes);

(b) Fixed and income interest at rates not exceeding in the aggregate five per cent (5%) per annum on the outstanding new bonds;

(c) Repairs, maintenance, replacements and renewals in connection with the properties, except as the same may be paid from insurance or condemnation moneys or depreciation and/or obsolescence reserves;

(d) The fees, charges and expenses of the trustee (not including acceptance, authentication and registration fees in connection with the original acceptance of the trust and the original issuance of the new bonds, which fees are to be paid as part of the reorganization expenses and from funds to be provided for that purpose); compensation of the voting trustees and of their depository and



## Exhibit A-1—(Continued)

agent, and all other expenses of such voting trustees and of such voting trust; and all expenses in connection with the transfer of the stock of the new corporation.

The amount of the consolidated net income of the new corporation and its subsidiaries for the purpose of income interest payments shall be computed in the same manner as for sinking fund purposes, except that the amount of the income interest in item (b) above shall not be deducted in making such computation.

All sums received by the new corporation and/or its subsidiaries from the sale of capital assets shall be applied to one or more of the following purposes: (a) purchase and retirement of the new bonds; (b) deposit in the sinking fund; and (c) acquisition of capital assets. The new corporation shall be entitled to no credit whatsoever upon its sinking fund obligations by reason of any such application of sums received from the sale of capital assets.

5. The new trust indenture shall provide that the new corporation shall file with the trustee on or before the tenth (10th) day preceding each semi-annual interest payment date schedules and reports sworn to be correct by an officer of the new corporation, showing in reasonable detail the net income of the new corporation and its subsidiaries on a consolidated basis for the six (6) months period ended two (2) months preceding such inter-



## Exhibit A-1—(Continued)

est payment date, and the balance sheet of the new corporation and its subsidiaries on a consolidated basis at the end of said period, together with schedules showing the computation and the amount, if any, required for deposit with the trustee in the sinking fund aforesaid, and such other information as the trustee shall require; and that the new corporation shall file with the trustee on or before the tenth (10th) day preceding each sinking fund payment date, similar schedules and reports certified by public accountants satisfactory to the trustee covering the operations for the twelve (12) months ended two (2) months preceding such sinking fund payment date. Such schedules and reports as may be rendered by public accountants as aforesaid shall be determinative. The trustee and its representative shall have access to the books of the new corporation and its subsidiaries and of the property subject to the new trust indenture at any time or times [60] for the purpose of making examination of the same, and such books and records and the schedules and reports above referred to shall be in such form and shall contain such data as may be required by the trustee.

6. Moneys deposited in the sinking fund shall be used from time to time by the trustee for the retirement of the new bonds either by purchase at public or private sale, at prices not exceeding the redemption price thereof, or by redemption in such manner and upon such notice as the new trust indenture may provide, at prices not exceeding the

## Exhibit A-1—(Continued)

par value thereof, together with any accrued and unpaid fixed interest thereon.

7. The new trust indenture shall provide that with the consent of the holders of seventy-five per cent (75%) in principal amount of new bonds then outstanding:

(a) The new trust indenture may be released and the new bonds satisfied (but only with the written consent of the Commissioner of Corporations of the State of California so long as there is such a commissioner) upon payment or delivery to the trustee for the benefit of the holders of all the new bonds then outstanding, of a consideration (which may be money, securities or any other consideration), which consideration may be less than the principal amount of the new bonds then outstanding;

(b) With the consent of the new corporation and the trustee, any of the terms and provisions of the new trust indenture or the new bonds may be altered, eliminated or supplemented; or

(c) The new trust indenture may be subordinated to a new mortgage or trust deed or other encumbrance for such purposes and in such amount as such percentage of the holders of the new bonds then outstanding shall approve.

8. The new bonds and the new trust indenture shall otherwise be in such form and shall contain such terms, provisions and covenants, not inconsistent with the terms hereof, as the bondholders' committee may determine.

## Exhibit A-1—(Continued)

## V.

PROVISIONS OF VOTING TRUST  
AGREEMENT

The new stock to be issued for the benefit of the bondholders will be issued to voting trustees under a voting trust agreement and participating certificates shall be issued by the voting trustees to the bondholders representing the new stock to which they are entitled. The voting trust agreement shall be executed by the voting trustees and the new corporation. The voting trust agreement shall endure for a period of twenty-one years unless earlier terminated (a) by a majority of the voting trustees; or (b) by instruments in writing executed (1) by the holders of participating certificates representing fifty per cent or more of the new stock held under the voting trust and (2) by the holders of fifty per cent or more of the aggregate principal amount of the new bonds then outstanding.

The initial voting trustees shall be designated by the bondholders' committee. The voting trust agreement will provide that at any time any one of the voting trustees may be removed by a majority of the voting trustees and that at any time one or more of the voting trustees may be removed by instruments in writing executed (1) by the holders of participating certificates representing fifty per cent or more of the new stock held under the voting trust and (2) by the holders of fifty per cent or more of the aggregate principal amount of the new bonds then outstanding; and also that in the event of the

## Exhibit A-1—(Continued)

death, resignation, incapacity to act or removal of any voting trustee or voting trustees, successor or successors may be appointed by the remaining voting trustees or voting trustee, but that in the event no such appointment is made within thirty (30) days from and after the death, resignation, incapacity to act or removal of any voting trustee, a successor may be appointed by instruments in writing executed (1) by the holders of participating certificates representing fifty per cent or more of the new stock held under the voting trust and (2) by the holders of fifty per cent or more of the aggregate principal amount of the new bonds then outstanding.

The voting trustees shall be entitled to reasonable compensation for their services, but for their usual and ordinary services the compensation of each voting trustee shall not exceed \$20.00 per meeting. The depository and agent of the voting trustees shall be such Los Angeles bank or trust company as may be designated by the voting trustees, and such depository and agent shall be entitled to reasonable [61] compensation. The compensation of the voting trustees and of their depository and agent, and all other expenses of the voting trustees and of the voting trust, shall be payable by the new corporation from the operating receipts of its property. If unpaid, such compensation and expenses shall constitute a lien on the stock issued to the voting trustees.

The voting trustees shall possess, and in their dis-



## Exhibit A-1—(Continued)

cretion shall be entitled to exercise, all rights and powers of the holders of the new stock held under the voting trust agreement; provided, however, that in the event the voting trustees shall propose (a) to sell all or substantially all of the properties of the new corporation or the new stock held under the voting trust agreement and/or (b) to lease, transfer, convey, mortgage or encumber all or substantially all of the properties of the new corporation, such proposal shall be first mailed to the holders of the participating certificates and of the new bonds, if any, then outstanding; and in the event within thirty (30) days thereafter written dissents to such proposal shall be filed with the depositary and agent executed (1) by the holders of participating certificates representing fifty per cent or more of the new stock held under the voting trust and (2) by the holders of fifty per cent or more of the aggregate principal amount of the new bonds then outstanding, then in such case the voting trustees shall not have the right to consummate the proposal so submitted. The voting trustees may in their discretion, but shall not be required to, submit in like manner and with like effect any proposal which they shall deem substantially to affect the rights or interests of the new corporation or of the holders of securities issued by it.

The voting trust agreement may be amended by resolution of all of the voting trustees, but if in their opinion (which shall be conclusive) such amendment will materially or substantially affect the rights of the holders of participating certificates,



## Exhibit A-1—(Continued)

the trustees shall mail notice of such proposed amendment to the holders of the participating certificates and of the new bonds, if any, then outstanding, and such amendment shall not become effective if within thirty (30) days thereafter written dissents to such amendment shall be filed with the depository and agent executed (1) by the holders of participating certificates representing fifty per cent or more of the new stock held under the voting trust and (2) by the holders of fifty per cent or more of the aggregate principal amount of the new bonds then outstanding.

The voting trust agreement shall be in such form and contain such terms, provisions and covenants not inconsistent with the terms hereof as the bondholders' committee may determine.

## VI.

## PAYMENT OF CLAIMS, COSTS OF ADMINISTRATION AND ALLOWANCES

No claims are to be paid in cash, in whole or in part, pursuant to this plan except those claims, if any, representing current bills and charges of the receiver remaining unpaid at the time of the commencing of the reorganization proceedings and the appointment of the reorganization trustee, but all costs of administration and other allowances made by the court shall be paid in cash. The bondholders' committee shall be entitled to compensation for its services in an amount not exceeding that provided for by the bondholders' agreement. The preferred

## Exhibit A-1—(Continued)

stockholders' committee shall be entitled to such reasonable compensation for its services as the court may allow. The disbursements, liabilities and expenses of the bondholders' committee and of the preferred stockholders' committee, including the compensation and expenses of their respective attorneys, in such amounts as the respective committees shall determine, and the compensation of the respective committees will be paid as part of the expenses of the reorganization.

## VII.

METHODS OF BECOMING A PARTY  
TO THE PLAN

A. Holders of present bonds not heretofore deposited under the bondholders' agreement: Holders of the present bonds not heretofore deposited under the bondholders' agreement may approve and accept the plan by depositing their bonds with the depositary under the bondholders' agreement, unless the bondholders' committee shall have directed such depositary not to accept additional deposits at such time, or by filing, if the bondholders' committee shall so determine, with the bondholders' committee a written approval and acceptance of the plan in the form designated by the bondholders' committee, [62] and by making such deposit or filing such approval and acceptance, will authorize the bondholders' committee on their behalf to approve the plan, to accept the plan in writing and file such acceptance in the reorganization proceedings, and to carry

## Exhibit A-1—(Continued)

the plan into effect during the reorganization proceedings or otherwise, as herein provided.

Holders of the present bonds may approve and accept the plan in the reorganization proceedings by such other method as may be specified by the judge.

B. Holders of certificates of deposit heretofore issued under the bondholders' agreement: All depositors of the present bonds who shall not file dissents to the plan and notices of withdrawal of their bonds from the bondholders' agreement as provided therein, and within the time therein provided, shall thereby be deemed and treated as assenting to and bound by the plan and shall thereby authorize the bondholders' committee on their behalf to approve the plan, to accept the plan in writing and file such acceptance in the reorganization proceedings, and to consummate the plan either in the reorganization proceedings or otherwise, as herein provided.

Prior to the submission of this plan to the present bondholders, it will have been approved by the court in the foreclosure action in which the receiver has heretofore been appointed and will have been filed with the depository under the bondholders' agreement. Copies of the plan are to be mailed to each depositing bondholder in the manner provided in subparagraph (a), Section IV, of the bondholders' agreement. The adoption of this plan by the bondholders' committee shall constitute the adoption of a revised plan and/or amendment of the plan of reorganization set forth in Section III of the bond-

## Exhibit A-1—(Continued)

holders' agreement, and shall constitute an amendment of the bondholders' agreement expressly authorizing the bondholders' committee, on behalf of all holders of certificates of deposit heretofore issued who shall not file dissents and notices of withdrawal as provided in the bondholders' agreement and within the time therein provided, and on behalf of all holders of certificates of deposit hereafter issued, to approve the plan, to accept the plan in writing and file such acceptance in the reorganization proceedings, and to consummate the plan either in the reorganization proceedings or otherwise, as herein provided.

C. Preferred stockholders whose stock has not heretofore been deposited under the preferred stockholders' agreement: Preferred stockholders who have not heretofore deposited their stock under the preferred stockholders' agreement may approve and accept the plan by depositing their preferred stock with the depositary under the preferred stockholders' agreement, unless the preferred stockholders' committee shall have directed such depositary not to accept additional deposits at such time, or by filing, if the preferred stockholders' committee shall so determine, with the preferred stockholders' committee the written approval and acceptance of this plan in the form designated by the preferred stockholders' committee, and by making such deposit or filing such approval and acceptance will authorize the preferred stockholders' committee on their behalf to approve the plan, to accept the plan in



## Exhibit A-1—(Continued)

writing and file such acceptance in the reorganization proceedings, and to consummate the plan either in the reorganization proceedings or otherwise, as herein provided.

Holders of preferred stock may approve and accept the plan in the reorganization proceedings by such other method as may be specified by the judge.

D. Holders of certificates of deposit heretofore issued under the preferred stockholders' agreement: All depositors of preferred stock under the preferred stockholders' agreement who shall not file notice of dissent to the plan and who shall not withdraw from the preferred stockholders' agreement, as provided in said agreement and within the time therein provided, shall thereby assent to the plan and shall authorize the preferred stockholders' committee on their behalf to approve the plan, to accept the plan in writing and file such acceptance in the reorganization proceedings, and to consummate the plan either in the reorganization proceedings or otherwise, as herein provided.

The preferred stockholders' committee has adopted and approved this plan and has caused or will cause a copy of the plan to be lodged with the depositary, and notice is to be given, in the manner provided in Articles Third and Ninth of the preferred stockholders' agreement. The adoption of this plan by the preferred stockholders' committee shall constitute an amendment of the preferred stockholders' agreement expressly authorizing said committee, on behalf of all holders of certificates of



## Exhibit A-1—(Continued)

deposit heretofore issued who shall not file notice of dissent and who shall not exercise their right of withdrawal as provided in the preferred stockholders' agreement and within the time therein provided, and on behalf of all holders of certificates of deposit hereafter issued, to approve the plan, to accept the plan in writing and file such acceptance in the reorganization proceedings, and to consummate the plan either in the reorganization proceedings or otherwise, as herein provided. [63]

E. Unsecured creditor: Pacific Public Service Company, as the only unsecured creditor of the debtor affected by the plan, may accept the plan in writing and file such acceptance in the reorganization proceedings, or such acceptance may be contained in a reorganization agreement between the bondholders' committee, the preferred stockholders' committee and said Pacific Public Service Company providing for the consummation of this plan, and the filing of a signed copy of such reorganization agreement in the reorganization proceedings shall constitute the filing of the acceptance of the plan by said Pacific Public Service Company.

If carried into effect in the reorganization proceedings, the plan, upon confirmation by the court, shall be binding upon all bondholders and all preferred stockholders and all other creditors and stockholders of the debtor, including those who have not, as well as those who have, accepted it.

If the plan shall not be carried into effect in the reorganization proceedings, the bondholders' com-

## Exhibit A-1—(Continued)

mittee may determine the time, and may extend or limit the time, within which the bondholders may deposit under or otherwise assent to the plan, may impose restrictions in respect of any such deposits or assents and may in its discretion, either generally or in particular instances, permit bondholders to become assenting parties to the plan and the bondholders' agreement without the deposit of their bonds or any appurtenant coupons, under such terms and conditions, either generally or in particular instances, as the bondholders' committee in its discretion may impose.

## VIII.

## EXECUTION OF THE PLAN

The plan has been prepared in contemplation of its being consummated in the reorganization proceedings. If, however, the court shall fail to confirm the plan and shall dismiss the reorganization proceedings, or if for any other reason it shall in the judgment of the bondholders' committee become necessary or desirable that the plan be consummated otherwise than in the reorganization proceedings, then the plan shall be consummated in such manner as to accomplish, in the judgment of the bondholders' committee, substantially similar results for the bondholders participating in the plan, independently of the reorganization proceedings. In such case the bondholders' committee, in order that the new corporation may acquire the properties, may apply towards the payment of the sum

## Exhibit A-1—(Continued)

required to be paid in cash at the foreclosure or other sale, money to be paid to the new corporation pursuant to this plan and/or the proceeds of any loan procured by the new corporation, which loan, at the option of the new corporation, may be secured by a mortgage, trust deed or other encumbrance on the properties, superior to the new trust indenture.

Subject, in the reorganization proceedings, to the approval of the judge, the bondholders' committee and the preferred stockholders' committee shall act jointly as a reorganization committee for the purpose of consummating the plan and shall have all of the authority, powers and rights vested in them pursuant to the bondholders' agreement and the preferred stockholders' agreement respectively (except and to the extent that, in the reorganization proceedings, any such authority, powers or rights may be inconsistent with Section 77B). The plan may be executed by any one or more of the means authorized or permitted by Section 77B, whether or not such means are expressly mentioned in the plan; or if the plan shall not be consummated in the reorganization proceedings, by such means as the bondholders' committee in its discretion shall determine. Without limiting the generality of the foregoing, the plan shall be executed in the reorganization proceedings at such time after its confirmation as the judge shall prescribe, and otherwise at such time as shall be specified by the bondholders committee, by the organization of the new cor-

## Exhibit A-1—(Continued)

poration, the sale at a fair upset price, or the conveyance and transfer without a sale, to the new corporation of the properties, free and clear of all claims of the debtor, its stockholders and creditors (except creditors not affected by the plan), the execution by the new corporation of the new trust indenture, the issue and delivery of the new bonds and new stock; the issue by the voting trustees of participating certificates as herein provided; the payment in cash of the costs of administration and allowances as provided in Article VI hereof; the execution of such other instruments and delivery of such other securities and the performance of such other acts as the judge, or the respective committees (if in the reorganization proceedings, with the approval of the judge) shall deem necessary or proper for the purpose of consummating the plan. Subject, in the reorganization proceedings, to the approval of the judge: the respective committees shall have full power and authority to prepare, approve, execute or deliver any and all instruments of whatsoever character in their opinion necessary or proper for the purposes of the plan; the form and terms of all certificates or articles of incorporation, bonds, stock certificates, voting trust agreements, participating certificates, fractional certificates and agreements providing for their issue and all other instruments and agreements necessary or proper to consummate the plan shall be such as the bondholders' committee shall determine; the respective committees shall have the authorities and powers



## Exhibit A-1—(Continued)

expressly conferred upon them under the provisions of the plan and the bondholders' agreement and the preferred [64] stockholders' agreement respectively, and also such incidental powers deemed by them necessary and proper to enable them to carry out the purposes of the plan and said respective agreements.

If the plan is consummated in the reorganization proceedings, changes and modifications therein may be made in the manner provided in subdivision (f) of Section 77B; if the plan is consummated otherwise than in the reorganization proceedings, it may be amended or modified in the manner provided in the bondholders' and preferred stockholders' agreements respectively. If in the reorganization proceedings any change or modification shall be made in the plan in the manner provided in subdivision (f) of Section 77B which in the opinion of either committee materially affects the rights of its depositors, then its depositors may be given the right to dissent and to withdraw in the manner provided in its agreement.

As its voluntary act and not pursuant to any order of court in the reorganization proceedings, the debtor shall transfer and convey, by way of quitclaim, to the new corporation all of its properties, both real and personal, tangible and intangible, and each holder of the old bonds shall, as a condition precedent to obtaining the new securities, assign and transfer his old bonds to the trustee under the new trust indenture, to be held as security for the



## Exhibit A-1—(Continued)

new bonds. Notwithstanding that Section 77B or any part thereof may be finally held unconstitutional or invalid, and such holding may invalidate any order or decree confirming the plan or any part thereof, or any other order or decree in the reorganization proceedings, or the plan or any part thereof, or any act done or document executed in connection with the plan, nevertheless such transfer and conveyance of the debtor's properties to the new corporation, and such assignment and transfer of the old bonds to the trustee under the new trust indenture, and the execution and delivery of the new trust indenture and the new bonds, and the issuance of the new stock, and the execution of the voting trust agreement and the issuance of the participating certificates thereunder, shall each and all be deemed to be valid and effective acts and documents for all purposes; and it is hereby declared to be the intent and purpose of all parties hereto and of all persons participating in the plan that all such acts and documents as would otherwise be affected by any such holding, shall have the same force and effect as though done and executed outside and independently of the reorganization proceeding.

## Article IX.

INDEMNITIES AND ASSUMPTIONS  
OF OBLIGATIONS

The new corporation shall agree to indemnify the reorganization trustee, the trustee under the present indenture, the bondholders' committee and the pre-

## Exhibit A-1—(Continued)

ferred stockholders' committee against all loss, cost, liability and expense, including, without limiting the generality of the foregoing, all income and other tax liability arising out of the operation of the properties or the deposit of the present bonds and the preferred stock, or the plan of reorganization, or any transaction required or authorized by this plan or by the judge in connection with this plan. The new corporation shall assume and agree to pay and perform all contracts and obligations of the receiver and of the reorganization trustee in connection with the improvement, management and operation of the properties which shall remain unpaid or unperformed and likewise all contracts and obligations of the debtor to its subsidiaries and affiliated companies. The new corporation shall also enter into any and all agreements with the debtor, the trustee under the present indenture, the reorganization trustee, the bondholders' committee and the preferred stockholders' committee, or any of them, which the judge shall find necessary or proper in connection with consummating this plan of reorganization.

Anything contained in any provision of the plan to the contrary notwithstanding, the new corporation may use any of its funds for the purpose of discharging its obligations on the indemnities and other agreements provided for in this Article IX.

The acceptance of any of the new bonds, the new stock or participating certificates therefor, or any other new securities pursuant to the plan shall

## Exhibit A-1—(Continued)

estop such acceptor from questioning the conformity of such securities in any particular to any provision of the plan and shall constitute full ratification by such acceptor of all acts and proceedings of the bondholders' committee, the preferred stockholders' committee, the reorganization trustee, the new corporation and the trustee under the present indenture in consummating the plan. The receipt by holders of certificates of deposit representing a majority in amount of the present bonds and the receipt by holders of certificates of deposit representing a majority in amount of the preferred stock, of new securities under any of the provisions of the plan shall constitute a release and discharge of the bondholders' committee and the preferred stockholders' committee respectively, and the reorganization trustee, the new corporation and the present trustee, on the part of all holders of the present bonds and preferred stock, respectively, from all liability and accountability of every kind, character and description whatsoever, save the obligation of the new corporation to make delivery of the new securities to the holders of the present bonds and preferred stock in accordance with the plan, upon presentation and surrender of the present bonds (with all appurtenant coupons) and the preferred stock, respectively. [65]

In order to evidence the adoption of the foregoing plan of reorganization by the bondholders' committee and the preferred stockholders' committee respectively, each of said committee has caused

Exhibit A-1—(Continued)

said plan to be executed by at least a majority of its members.

Dated March 1, 1935.

CALIFORNIA CONSUMERS  
COMPANY BONDHOLDERS'  
PROTECTIVE COMMITTEE

By W. D. COURTRIGHT  
(W. D. Courtright)  
EDWARD L. EYRE  
(Edward L. Eyre)  
JOHN EARLE JARDINE  
(John Earle Jardine)  
FLOYD C. MERRITT  
(Floyd C. Merritt)  
GUY WITTER  
(Guy Witter)

CALIFORNIA CONSUMERS  
COMPANY PREFERRED  
STOCKHOLDERS' COM-  
MITTEE,

By GARRETTSON DULIN  
(Garrettson Dulin)  
WYATT H. ALLEN  
(Wyatt H. Allen)  
JOHN BULLARD  
(John Bullard)  
HERBERT E. HALL  
(Herbert E. Hall)  
CATESBY C. THOM  
(Catesby C. Thom)

Before the Tax Court of the United States

Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Court Room No. 401, Civic Auditorium,  
San Francisco, California.

November 26, 1943, 11:25 A. M.

(Met pursuant to notice.)

Before: HON. C. R. ARUNDELL, Judge.

Appearances:

Granville S. Borden, Esq., Sigvald Nielson, and  
Scott C. Lambert, appearing for Pacific Public  
Service Company, Petitioner, 225 Bush Street, San  
Francisco, California.

Harold D. Thomas, Esq., appearing for Commis-  
sioner of Internal Revenue, the Respondent, Sharon  
Building, San Francisco, California. [68]

### PROCEEDINGS

The Clerk: Docket No. 2159, Pacific Public Serv-  
ice Company.

Mr. Thomas: Ready.

Mr. Lambert: Ready. The appearances are Gran-  
ville S. Borden and Scott C. Lambert for the Peti-  
tioner.



Mr. Thomas: Harold D. Thomas for the Respondent. The Respondent at this time offers a motion to amend the Answer, accompanied by an amendment to the Answer. Petitioner's counsel has been served with a copy of the proposed amendment and I believe has no objection.

The Court: It will be allowed.

Mr. Lambert: With leave of the court, the Petitioner would like leave to file an amendment to its Petition. It involves a minor capital stock tax adjustment in which we charge error to the Commissioner, and Respondent has admitted the error and admits the facts. With leave of the Court, we would like to file the Petition.

The Court: I suppose the Petition should come in just ahead of the answer.

Mr. Lambert: That was a previous amendment to the Answer, your Honor.

The Court: Then what about this point? Do you admit the amended——

Mr. Thomas: We have an Answer to that amendment [70] already, your Honor, and I will file it at this time.

The Court: It will be received.

Mr. Thomas: It is an admission that the Respondent erred.

#### STATEMENT ON BEHALF OF PETITIONER

Mr. Lambert: May it please the Court, this dispute arises out of a sale by the Petitioner in the year 1940 of certain stock and bonds in the California Consumers Corporation. The Petitioner

claims a refund due to the loss on this sale and the Respondent denies the refund and has attempted to assess a deficiency based on an adjustment to the basis of the Petitioner.

The issue involves the basis of the Petitioner for the stock and bonds sold in 1940. This basis question goes back and the real issue in this controversy is the nature of a reorganization exchange which took place in 1935 by which the California Consumer Corporation merged through bankruptcy proceeding involving the California Consumers Company, and with the Court's indulgence, I think it would aid in the presentation of the case to simply and very briefly review the facts of this entire controversy.

Petitioner in 1928 acquired in exchange for shares of its own stock the common stock, all the outstanding shares, of the California Consumers Company, an ice and cold storage company doing business in Southern California through a number [71] of subsidiaries. During the years 1928 to 1933 the Petitioner also acquired \$75,000 in principal amounts of First Mortgage Gold Bonds of the California Consumers Company. During the same period Petitioner acquired 902 shares of the preferred stock of the California Consumers Company. The purchase price of the bonds and the stock is not in dispute. Petitioner paid some \$54,000 for the bonds and some \$51,000 for the stock.

During the same period Petitioner made cash advances to the California Consumers Company totaling \$478,000. In May of 1933 these advances were represented by a 5 per cent promissory note pay-

able on demand, executed by the California Consumers Company.

In October of 1933 the California Consumers Company defaulted in the semi-annual interest obligation due on its First Mortgage Bonds, and the trustee under the mortgage, the First National Bank of Los Angeles, petitioned the Federal District Court for the appointment of a temporary receiver and a foreclosure upon these bonds. A temporary receiver was appointed and took over the properties of the California Consumer Company. The year 1933 and the commencement of the bankruptcy proceedings of the California Consumers Company is the first date of importance.

During the years from October, 1933, until March 1, 1935, the bondholders formed a protective committee, and the preferred shareholders formed a protective committee, and jointly [72] these two committees, with the Petitioner as unsecured creditor, proposed a plan of reorganization to the Federal Court which was accepted and approved September 30, 1935.

It is this reorganization plan and exchange which is in dispute here, your Honor. Under that exchange the bondholders received bonds in the same amount, the same principal amount, of the new corporation formed, and the preferred shareholders and the unsecured creditor, the Petitioner here, received stock in the new corporation. The new corporation issued \$3,496,500 worth of First Mortgage Bonds to replace the old bonds. They issued 54,000 shares of stock, which was divided between the preferred

shareholders, who received 42 per cent, and the Petitioner, who received 6 per cent, representing its unsecured claim on the note.

The Petitioner claims the 1935 transaction to have been one from which no gain or loss is recognized under two sections of the Internal Revenue Code, the 1934 Code at that time. The Respondent denies the tax-free character of that exchange and finds that Petitioner acquired a new basis under that exchange for its bonds and stock in the new company. Petitioner claims the reorganization exchange to have been tax free under two sections of the law; first, it was a reorganization within Section 112 (g) (1) (b) of the Revenue Act of 1934, which provides that a reorganization includes the acquisition by one corporation solely in exchange for its voting stock of substantially all the properties of another [73] corporation.

The Court: Say that again?

Mr. Lambert: This Section 112 (g) (1) (b) provides that a reorganization includes the acquisition by a corporation solely in exchange for its voting stock of substantially all the properties of another corporation.

The Court: Well, is that true here?

Mr. Lambert: Yes. That is true. In 1939, your Honor will remember the Hendler legislation amended this section to add that in determining whether an exchange is solely for voting stock an assumption of a liability by the transferee corporation shall be disregarded. We contend that this exchange comes exactly within that Section of the



1934 Act, as amended by the 1939 Act, in that the new corporation issued its voting stock and assumed the old bonds of the old corporation by issuing its new bonds, and it is an exchange solely for voting stock plus an assumption of liabilities. The case of Harden F. Taylor, 43 BTA, which was affirmed in the Second Circuit, 128 Fed. 2, held that in determining whether or not an exchange is solely for voting stock the issuance of new bonds in substitution for old bonds which were in default shall be deemed to be an assumption of the old bonds for the purpose of applying this section.

The Petitioner also claims——

The Court: Well, there is a sort of lack of continuity [74] in that transaction, isn't there? Were the old stockholders wiped out?

Mr. Lambert: The old common shareholder was wiped out. That was the Petitioner. The Petitioner owned all the common shares of the old corporation and their interests were evaporated in the reorganization exchange. Under the Supreme Court's language in the Alabama Asphalt Limestone Case your Honor will recall that they said in the reorganization bankruptcy proceedings under 77 (b) the creditors or bondholders take effective ownership of the old corporation and freeze out the common shareholders, and the Petitioner lost its interest as a common shareholder in the new corporation. It had a basis of \$1,500,000 for which no claim is made. Petitioner's claim is based upon its proprietary interest as bondholder, preferred shareholder, and unsecured creditor, in



exchange for which it received bonds and stock of the new corporation.

Petitioner also claims, your Honor,—

The Court: Well, your point is that the new California Consumers, whatever it is called, acquires the property of the old California Consumers under this provision of the Revenue Act 112 (g) (1) (b)?

Mr. Lambert: Yes.

The Court: And that no gain or loss would be recognized, even though there is not a continuity between the old stockholders and the new holders?

Mr. Lambert: There is no continuity, your Honor, [75] between the old common shareholders of the old corporation and the shareholders of the new. The common shareholders lost their interest when the reorganization bankruptcy proceedings were instituted. The corporation was insolvent.

The Court: Well, what application is there of the Hendler principle in here?

Mr. Lambert: Well, that simply under the Hendler legislation in 1939 the assumption of liabilities was not removed from the reorganization tax-free character.

The Court: In other words, it is not treated as other property?

Mr. Lambert: That is right. It is an assumption of liability. It is not money or other property paid to the transferrors.

The Court: Go ahead. These are rather difficult to follow.

Mr. Lambert: I hope you will feel free in asking questions, your Honor.

The Petitioner also contends that the exchange comes clearly within Section 112 (b) (5) of the Revenue Act of 1934, which provides that no gain or loss shall be recognized if one or more persons transfer property to a new corporation and immediately after the exchange they are in control of said corporation. Where the exchange is made by two or more persons, in determining whether the exchange is exempt, [76] the interests both before and after the exchange must be in proportion.

The Court: Well, how does that come in here?

Mr. Lambert: The parties in this case were the bondholders and the preferred shareholders and the unsecured creditor, who transferred their interests in the old corporation to a new corporation in exchange for stock and securities in the new corporation, and under the Cement Investors case in the Supreme Court, this transaction comes right within the effect of that case, which held that such a case comes within 112 (b) (5) of the Revenue Act of 1934 as a transfer by two or more persons who remain in control of the corporation after the exchange.

The Court: Just what are the mechanics in this case? There is a new corporation organized and do the bondholders of the old corporation transfer their interests or stock in the new corporation?

Mr. Lambert: Yes.

The Court: And then the new corporation thereafter, in a separate transaction or as some part of the same transaction, acquires the assets of the old company?

Mr. Lambert: Well, the assets of the old corporation, of course, were transferred by the receiver.

The Court: For what?

Mr. Lambert: To the new corporation in consideration [77] of the issuance by the new corporation of its stock to the parties in interest, the bondholders and the persons who had a proprietary interest in the new corporation.

The Court: And I presume that they assumed some of the bonded indebtedness or what?

Mr. Lambert: The new corporation assumed the old bonded indebtedness of the old corporation, it is our contention.

The Court: It seems to me what you state are two different transactions.

Mr. Lambert: There are two separate sections of the law, of course.

The Court: I know there are two sections of the law, but you are stating two separate transactions, aren't you?

Mr. Lambert: Well, within the reorganization section it comes because the new corporation has received property of an old corporation which is in bankruptcy, and it receives that and issues therefor both voting stock and assumes liability. It comes under 112 (b) (5) because the persons who owned a proprietary interest in the old cor-

poration, the bondholders, the creditors, and the preferred shareholders, transfer their interests under the reorganization exchange to the new corporation solely for its stock and they remain in control thereafter. [78]

Your Honor will recall that under the Alabama Asphalt and Limestone Case and its companion cases that in 77 (b) reorganizations the parties in interest are the creditors who are foreclosed and they are in control of the old corporation and their interests are transferred to the new corporation in exchange for its stock and securities and the exchanges are tax free.

The Court: Didn't the Court make some distinction between cases where these transactions occurred before a certain date and where they occurred after a certain date?

Mr. Lambert: You mean in those cases? Yes, your Honor in the——

The Court: I have forgotten what that was.

Mr. Lambert: In the Alabama case the exchange took place under the 1928 Act, and in that case there was no need for the exchange solely to be in consideration of voting stock. The Southwest Consolidated case came along under the new Act which had become more strict in the definition of what had to be issued by the new corporation, and it was found that it had to be solely voting stock. In the Southwest case cash was issued and paid to certain parties and the transaction was not exempt because it was not solely for voting stock.

The Court: How does that fit in here?



Mr. Lambert: No consideration was paid by the new corporation except its voting stock and new bonds which constituted [79] an assumption of the old bonds. No cash was paid to any party, no consideration other than the new stock and bonds, and that came within the Cement Investors case because in a similar transaction they held that 112 (b) (5) was applicable because the persons who had the proprietary interest in the old corporation transferred their interest to the new corporation solely in exchange for its stock and securities, and remained in control, provided that their interests are proportionately both before and after the exchange.

That is the issue between the Petitioner and the Respondent on this exchange under 112 (b) (5), and we have brought today the party who had the leading influence in the reorganization proceedings and we would like to offer his testimony later. He saw this from the beginning right through as head of the preferred shareholders committee, right through the culmination of the reorganization plan, and his testimony the petitioner offers on the question of the issue of the proportionate interest of the parties before and after the exchange.

The Court: How do you figure that, that they would have the same proportionate interest? Do you forget those advances?

Mr. Lambert: No, sir. The advances for which the Petitioner held its note were surrendered under the plan of reorganization and the Petitioner received 6 per cent of the new [80] stock. The bond-



holders, of whom Petitioner was one, surrendered their bonds and received new bonds in like principal amount, and the preferred shareholders surrendered their interest in exchange for new stock.

The Court: Share for share?

Mr. Lambert: No, sir. The stock issued by the new corporation was in excess of the shares issued by the old. There were 15,000 shares of the old corporation preferred stock, and the new corporation issued 54,000.

The Court: That money that was advanced disappears pretty much, doesn't it, in the reorganization?

Mr. Lambert: Well, Petitioner stood as a creditor——

The Court: And he ends up as a——

Mr. Lambert: As a preferred shareholder—I mean, as a shareholder.

The Court: As a common stockholder?

Mr. Lambert: Yes, sir.

The Court: Wouldn't that change the interests before and after?

Mr. Lambert: No, we contend that the value of the interest of petitioner and the other parties prior to the exchange was exactly the same as after although it was in a different form. The interest immediately prior to the exchange—the statute imposes that restriction—in other words, immediately prior to this exchange petitioner held an [81] interest in the new corporation, a proprietary interest, by virtue of its note. The value of that interest was appraised and determined by the parties.

They determined that petitioner was entitled by virtue of that to a 6 per cent interest in the new corporation, and that is what they received.

The Court: You mean that the 6 per cent would be the equivalent of \$478,000?

Mr. Lambert: Well, in value we contend that it was the equivalent.

The Court: Monetary value?

Mr. Lambert: I won't say, your Honor, that the new stock was worth \$478,000. I don't mean that. I mean the petitioner had an interest there in the new corporation which immediately prior to the exchange had a value commensurate with the value of the property which it received in the exchange. There were readjustments of interest.

The Court: If that is what that statute means, I just don't know but I assume that the moment it was decided that what you were going to get is 6 per cent of the common, the claim could never be worth more than that because that is all you could get.

Mr. Lambert: That is true.

The Court: But that helps to destroy this continuity that is always true in these reorganization cases to see whether the same interest prevails. [82]

Mr. Lambert: The continuity of interest is present here, your Honor, under the Supreme Court's definition of it in these reorganization cases. In those four cases they found the continuity of interest to be present where the creditors and the parties held proprietary interests in the old corporation which continued by virtue of

stock or new bonds in the new corporation, they need not be the same, but they remain in control. We contend that in the reorganization negotiations between the parties they appraised the interests of the various creditors, the bondholders, and the preferred shareholders and they allocated to each an interest in the new corporation which they were entitled to, and Petitioner had a basis for his new stock based on this note which it held and which it exchanged for new stock because of the tax free character of the transaction.

That is all we have.

#### STATEMENT ON BEHALF OF RESPONDENT

Mr. Thomas: If your Honor please, Respondent contends there was not a reorganization here in 1935 under Section 112 (g) of the 1934 Act. In this case bonds were issued in addition to stock which would entirely take it without the provisions of 112 (g) (1) (b).

We further take the position that even if there can be said to be a reorganization under 112 (g), there are no provisions of Section 112 which would preclude the recognition [83] of gain or loss at that time.

The Court: Why do you say it does not come under 112 (g) (1) (b)?

Mr. Thomas: We say that bonds were issued as well as stock. In other words, Respondent takes the position that the bonds of the old company, the liability of the old company on its bonds were not assumed by the new company. The plan speci-

fically provides that that liability is not assumed, and I might state that the provisions of the bonds of the old corporation and the bonds of the new corporation are substantially different. The old bonds were straight first mortgage 6 per cent bonds, maturing in 20 years; the new bonds were income bonds to the extent of 2 per cent of the 5 per cent interest which they bore.

The Court: What does that mean? There was only a requirement to pay 3 per cent certain?

Mr. Thomas: I believe that is the provision. It is contained in Article 4 of the plan, which will be offered in evidence, that the new bonds shall bear interest at the rate of 5 per cent per annum, the first payment of interest to be due 8 months after the date of the new bonds; of said interest at the rate of 5 per cent per annum, interest at the rate of 3 per cent per annum shall be fixed, that is, unconditionally due, and the balance of the annual interest shall be payable in annual installments but only if and to the extent [84] that the net income of the new corporation and its subsidiaries on a consolidated basis is available for the payment of interest.

The Court: Is the face amount the same?

Mr. Thomas: Yes, the face amount of the new bonds is the same.

Now, Respondent further takes the position that even if it be considered that the former holders of interests in the California Consumers Company, that is, the old company—even it be considered that they acquired equitable interests in the property



which was transferred to the new corporation, we claim that there is an anterior loss even if Section 112 (b) (5) of the Act were held otherwise applicable. In other words, if you take the exact interests which were held by the various parties in the old corporation and compare them with what they got in the new there is not the proportional interest retained as required by Section 112 (b) (5).

The Court: Why do you say that? Explain that.

Mr. Thomas: Well, because the unsecured creditor, which ranks the preferred stock, received a much less representation in the new corporation than the preferred shareholder. Mr. Lambert mentions the Cement Investors case where, I believe, the Supreme Court considered that the bondholders of the old corporation had in effect acquired equitable interests in the property. However, in that case the [85] bondholders were the only one that were represented in the reorganization, that, is they were the only ones that got anything in the new corporation. Here we have, of course, other interests, so as to whether you can compare this to Cement Investors in that respect is subject to doubt.

I might mention that here also there was a dividend suit against the Petitioner as—you might say, the Petitioner as director or controlling the old company, and the plan called for a dismissal of this dividend suit, so that I believe we will have to take into consideration the fact that that dividend suit against the petitioner was dismissed as a re-



sult of the plan. In other words, that is one of the considerations of the plan.

The Court: For a moment I have forgotten exactly what the point is that we want to determine. I mean, once we determine this reorganization question, then what is the immediate point?

Mr. Thomas: The ultimate point to decide is, I believe, that unless it be determined that the transaction in 1935 does not affect the cost of the original interests in the old corporation, then the Respondent's determination will simply have to be approved.

The Court: Have these shares been sold?

Mr. Thomas: They were sold in 1940. That is, all of the shares of preferred stock and bonds carrying with them [86] the right to participate and vote common stock, all of that was sold, all of the interest which petitioner got in 1935 in California Consumers Corporation was sold in 1940.

The Court: And they want the original cost basis?

Mr. Thomas: That is correct, your Honor, including the basis of approximately \$478,000 which was the amount of that note.

The Court: But if this transaction we have been talking about is a taxable one, then the petitioner agrees that the determination is correct?

Mr. Thomas: I believe so.

Mr. Borden: May I answer that? If there was not a tax free exchange in 1935, then the basis, of course, of the stock which was sold in 1940 would be the fair market value of the interest turned in

at that time. The agent has determined that amount to be a relatively small amount and has allowed us a loss for the year 1940. So, I think the answer to your inquiry is in the affirmative, that the determination of the Respondent would be held to be correct if it is held that there was a taxable exchange; and the resulting large, tremendous loss to the petitioner in the year 1935—in 1940 when it was sold, is the reason for the refund claim. The refund only amounts to \$30,000 because \$30,000 is all the amount that the taxpayer, Pacific Public Service Company, paid for the year 1940. That large interest in the other subsidiary [87] as a result of the consolidation in 1935 results in a deduction of only \$35,000. So, in the whole picture of the case, the taxpayer, a company earning close to \$1,000,000, will only have a deduction benefit for any year if it wins in this case in an amount equal to \$30,000.

Mr. Thomas: I have nothing further to state.

Mr. Lambert: Your Honor, the parties have entered into a stipulation of facts which we should like to submit. This stipulation contains all of the facts, I believe, necessary to the determination of the question of whether or not this be a transaction within 112 (g) (1) (b) as a reorganization; on the other question, on the proportionate interest issue, as I stated, we have testimony to offer, but all the facts necessary for the other issue are within this stipulation which we should like to offer.

Mr. Thomas: I don't exactly agree that quite

all the facts are there. I wish to offer a document or two in evidence.

The Court: We will receive the facts as stipulated. Now, Mr. Thomas, do you want to put in your evidence before the petitioner completes his case?

Mr. Thomas: No.

The Court: I thought you had some exhibits.

Mr. Thomas: It is part of Respondent's case, your Honor. I will wait for my regular time. [88]

Mr. Lambert: Mr. Hall is extremely rushed to-day and I would like to accommodate him by calling him at this time.

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### HERBERT E. HALL

a witness called on behalf of the petitioner, was duly sworn and testified as follows:

#### Direct Examination

By Mr. Lambert:

Q. Your name is?           A. Herbert E. Hall.

Q. You are a resident of San Francisco?

A. I reside across the Bay, and am practicing law in San Francisco.

Q. Your occupation is attorney?

A. Yes.

Q. Mr. Hall, are you familiar with the transaction which took place between the petitioner here and the bondholders and the California Consumers Company which culminated in the organ-

(Testimony of Herbert E. Hall.)

ization of the new California Consumers Corporation in 1935?      A. I am.

Mr. Lambert: If the Court please, I think it might facilitate your understanding of this if Mr. Hall just told his story as he recalls the facts. He was the——

By Mr. Lambert: [89]

Q. If you will indicate your part in the proceedings and just tell everything as you recall it——

Mr. Thomas: If your Honor please, I am going to object to the testimony. I believe it is entirely immaterial. We have here a stipulation of facts as to the entire plan and as to what took place and what was done. I believe any testimony as to what took place would be immaterial.

The Court: I don't presume counsel is going to vary the terms of the stipulation of facts by his testimony.

Mr. Thomas: I make the objection.

The Court: It will be overruled.

Mr. Thomas: Note an exception.

The Court: Note the exception.

A. In 1928 I purchased 100 shares of the preferred stock of California Consumers Company. In 1933 the bonds of that company went in default. As I recall, along about February of 1924 a committee of the bondholders——

The Court: 1934?

The Witness: 1934. The bonds, as I recall, went into default in 1933.

A. (Continuing): ——Early in 1934 a bond-



(Testimony of Herbert E. Hall.)

holders' protective committee was formed. As soon as the preferred stockholders heard of the formation of that committee, they thought it advisable that they form a committee, which they did, and I was appointed one of the members of that committee. Other [90] members were Mr. Dulin, of Los Angeles, Mr. Bullard of Los Angeles, Mr. Thom, of Los Angeles, and Mr. Wyatt Allen of San Francisco.

Shortly after the formation of that committee a meeting of it was held in Los Angeles, together with certain members of the bondholders committee. The bondholders committee told us that they would not recognize us in any transactions that they had with regard to the foreclosure of the bonds or the reorganization of the company unless the claim of the Pacific Public Service in the amount of approximately \$480,000 could be gotten out of the way, their position being that that claim was superior to the rights of the preferred stockholders, and until we were in a position to show that we were at least on a parity with or superior to the claim of Pacific Public Service we had no standing.

I was then delegated by the committee to negotiate with Pacific Public Service Company to see what could be done with regard to its claim. I had several conferences with Mr. R. W. Hanna, of Pacific Public Service Company, and the position that I took was that Pacific Public Service should do either one of two things; one, it should waive its claim entirely in favor of the preferred stockholders, or, two, that it should assign its claim to the



(Testimony of Herbert E. Hall.)

preferred stockholders committee on some sort of a basis whereby it would get a proportion of whatever shares of the stock of the new corporation [91] were allocated to the preferred stockholders. My reason for saying I thought the Pacific Public Service ought to be taken out of the picture was that I thought that to some extent they led the preferred stockholders to believe that with their interest in the California Consumers Company that the dividends would be protected and that there would be better management and all that, and it had been quite a blow to the preferred stockholders to find everything had dropped from under them.

He said that the company would not consider a complete waiver of the claim. He thought it was a justified claim and could be well supported by evidence.

As to the second point, he said that he thought that the company would be amenable to such a plan but he would have to take it up with his directors and would advise me. He had a meeting and advised me that they would consider a proposition of that sort and asked me what I thought would be the maximum amount that would be allocated to Pacific Public Service out of whatever we got. I said, not over 25 per cent. He agreed to that and the whole transaction was put in writing in the form of a letter from me as a member of the committee to him, and approved by him on behalf of Pacific Public Service Company.

Later, after further negotiation with the bond-

(Testimony of Herbert E. Hall.)

holders committee in determining to what extent the preferred stock holders were going to be scaled down on the reorganization, [92] I went back to him again and told him that we thought his interest should be cut down to  $12\frac{1}{2}$  per cent, or one-half of the original amount. To that he agreed and that was put in the form of a letter.

The plan finally went through pretty well as has been outlined to you. The bondholders received par for par for their old bonds, 5 per cent bonds, 3 per cent of the interest being certain and 2 per cent on an income basis. They also received 51 per cent of all of the new capital stock of the company. Originally there was something like 15,900 shares of preferred and about 20,000 of common. All that went out and there was merely one class of capital stock, as I recall, approximately 54,000 shares. Of those 54,000 the bondholders got 52 per cent, the preferred stockholders got 42 per cent, and Pacific Public Service got 6 per cent.

I then proceeded as a member of the committee to work with the bondholders committee on the drafting of the plan of reorganization and of the trust indenture, but, as far as I was concerned, that was the last contact that I had with Pacific Public Service other than to get their approval finally to the plan or reorganization.

I think that is about all.

By Mr. Lambert:

Q. Mr. Hall, may I ask one or two questions? These three groups you have described, these bond-

(Testimony of Herbert E. Hall.)

holders, yourself [93] and the other preferred shareholders, and Pacific, would you say they were strangers or friendly in a business sense?

A. I would say they were definitely strangers. There were conflicting interests all the way through the transaction. They were certainly dealing at arm's length. There was no time we all got together and said, "Boys, here is the plan." You had to fight for every point in connection with the reorganization.

Q. In other words, your negotiations were definitely on an arm's length basis where each was seeking to protect his own interest?

A. That is right, and get the most out of it that he could, no question about that.

Q. As a result of these negotiations, would you say that the relative interests in the new corporation were determined to be measured by the relative rights of the old corporation?

Mr. Thomas: That is objected to, your Honor. It calls for a pure conclusion on the part of this witness.

The Court: I think I am going to sustain that objection.

Mr. Lambert: That is all I have, Mr. Hall.

#### Cross-Examination

By Mr. Thomas:

Q. Mr. Hall, were you an officer or director of the [94] old company, the California Consumers Company?

A. No, I was not.

(Testimony of Herbert E. Hall.)

Q. Were you at the time of this bankruptcy and the transaction in question an officer or director of Pacific Public Service Company?

A. No, I was not.

Q. Were you ever an officer or director of California Consumers Corporation?      A. No.

Q. Mr. Hall, in connection with your negotiations, and particularly with Pacific Service Company, was the question of the dividends suit against that company and others ever discussed?

A. It was, to this extent, that in negotiating this matter with Mr. Hanna I pointed out to him that there was a suit against Pacific Public Service which would have to be eliminated before there could be any reorganization.

Q. You knew, did you not, that that suit charged the Pacific Public Service Company, as controller or director of the California Consumers Company, with having paid dividends on common stock and preferred stock out of capital?      A. I did.

Q. That is, in years prior to 1933?

A. That is right.

Mr. Thomas: That is all. [95]

Mr. Lambert: That is all, Mr. Hall.

The Court: Step down.

(Witness excused.)

Mr. Lambert: Your Honor, we should like to ask the Respondent to stipulate that this is a true copy of the claim for refund of the \$30,000 paid by petitioner and the grounds of this claim are as stated therein.



Mr. Thomas: (After examining): I have no objection.

The Court: It will be received.

The Clerk: Petitioner's Exhibit No. 1.

(Copy of claim for refund was received in evidence and marked Petitioner's Exhibit No. 1.)

Mr. Lambert: These are the plans of reorganization which are attached to the stipulation as Exhibit 1-A.

Mr. Thomas: I don't believe they have been marked as Exhibit 1-A, Mr. Lambert.

Mr. Lambert: I don't think they have.

(Plans of reorganization were received in evidence and marked Petitioner's Exhibit 1-A.)

Mr. Thomas: Respondent offers at this time a copy of the complaint filed in the Superior Court of the State of California by Guy L. Goodman, as temporary receiver, and others, against Pacific Public Service Company and others. There is also included in this offer a copy of the order of dismissal to the action dated January 3, 1936. [96]

The Court: What is the purpose of this?

Mr. Thomas: The purpose, your Honor, is to show that the dividend suit which was mentioned in the plan or reorganization, and which it is stated as a result of the plan shall be dismissed, was a suit against the Pacific Public Service Company and others for having declared dividends on the common and preferred stock of California Con-



sumers Company out of capital, in other words, having wrongfully paid out the funds.

The Court: I mean, that is the charge, but it was never adjudicated?

Mr. Thomas: It was not, no.

The Court: What is the significance of having it in this case?

Mr. Thomas: I think it shows that the dividend suit is something substantial, it just is not something that was thrown into the plan.

The Court: I mean, what will it have to do with it even if it was?

Mr. Thomas: I think it may well show why the petitioner as unsecured creditor was not proportionately represented in the securities, the stocks and bonds of the new company when issued.

The Court: I don't see how it shows that. I mean, I don't know what conclusion we can draw from it. Someone [97] makes a charge and that is as far as it goes.

Mr. Thomas: Well, I will admit it is not conclusive, your Honor, but inasmuch as——

The Court: It is not anything. I charge that you owe me a million dollars and that is the end of it. It doesn't prove you owe the million dollars.

Mr. Thomas: That is correct, your Honor, but still a suit is a suit, and whether you have admitted liability or denied it, suits are compromised, and I merely want to show that it is——

The Court: All right.

Mr. Thomas: That it is something substantial, as I claim.

Mr. Lambert: Your Honor, if you would entertain it, I should like to make an objection to the admission of that suit. In order to place it in the proper light, I will give this explanation of my objection. The suit was, as you say, simply a claim. A copy of the summons was never served on the defense. It was simply filed with the Superior Court nearly two years after the filing of the action within which suit had to be brought or it would expire under the state law. The plaintiffs approached the defense and asked them to enter a general appearance and stipulate that they could have an indefinite time within which to bring it to trial. In other words, the suit was hardly more than a frivolous [98] appeal, it was never tried, it was never even served on the defendant. The defendants entered into a stipulation that they should have an indefinite period within which to bring it to trial, but it was—I don't know the purpose of the suit—maybe it was to put them in some degree of position in the reorganization, but I should like to enter my objection to the admission of that claim.

The Court: You object on the ground that it is irrelevant?

Mr. Lambert: It is irrelevant and immaterial.

Mr. Thomas: I believe it is very relevant, your Honor. It shows the substantial nature of the action.

The Court: Well, I am going to overrule the objection.

Mr. Lambert: Your Honor, may I offer—

The Court: I don't see at the moment where

it can have one bit of bearing. In other words, it is sort of like the counsel who asks the witness if he didn't lie, and he says, "No, I didn't lie." Then you say, "Well, maybe he lied." Somebody makes a charge and they don't pursue it and I don't see how I can draw any conclusion on that.

Mr. Thomas: I think it at least explains the nature of the suit, and that is one of the considerations mentioned in the claim.

(Copy of complaint was received in evidence and marked Respondent's Exhibit A.) [99]

Mr. Lambert: Your Honor, the Petitioner would like to offer in evidence a certified copy of the stipulation which gave the plaintiffs unlimited time in which to bring it to trial.

Mr. Thomas: No objection.

The Court: Received.

The Clerk: Petitioner's Exhibit No. 2.

(Certified copy of stipulation was received in evidence and marked Petitioner's Exhibit No. 2.)

Mr. Lambert: That concludes the Petitioner's case, your Honor.

Mr. Thomas: I have nothing further.

The Court: Close the record.

(Discussion off the record.)

The Court: We will recess until 2:00 o'clock.

(Whereupon at 12:25 P.M. the case was closed.)

[Endorsed]: T.C.U.S. Filed Dec. 21, 1943. [100]

RESPONDENT'S EXHIBIT A

In the Superior Court of the State of California,  
in and for the County of Los Angeles

No. 367553

GUY L. GOODWIN, as Temporary Receiver on foreclosure of mortgaged property, under Order dated December 2, 1933, In Equity, Cause No. 122-C, in the United States District Court, for the Southern District of California, Central Division, SECURITY-FIRST NATIONAL BANK OF LOS ANGELES, as Trustee under the provisions of Trust Indenture dated as of April 2, 1928, from California Consumers Company to Los Angeles-First National Trust & Savings Bank, predecessor in interest of Security-First National Bank of Los Angeles, recorded April 27, 1928, in Book 7115, Page 83, of Official Records of the County of Los Angeles, State of California, and LUTHER S. BELL, a preferred stockholder of California Consumers Company,

Plaintiffs,

vs.

PACIFIC PUBLIC SERVICE COMPANY, a corporation, et al.,

Defendants.

DISMISSAL OF ACTION,  
with prejudice.

The above entitled action is hereby dismissed as to all defendants therein named, with prejudice

Respondent's Exhibit A—(Continued)

to all of the plaintiffs therein; and the Clerk of the above entitled Court is hereby authorized and directed to enter this dismissal of record.

Los Angeles, California, January 3, 1936.

O'MELVENY, TULLER &  
MYERS,

.....

(Walter K. Tuller)

.....

(Pierce Works)

.....

(Graham L. Sterling, Jr.)

In the Superior Court of the State of California,  
in and for the County of Los Angeles

No. 367,553

GUY L. GOODWIN, as Temporary Receiver on foreclosure of mortgaged property, under Order dated December 2, 1933, In Equity, Cause No. 122-C, in the United States District Court, for the Southern District of California, Central Division, SECURITY-FIRST NATIONAL BANK OF LOS ANGELES, as Trustee under the provisions of Trust Indenture dated as of April 2, 1928, from California Consumers Company to Los Angeles-First National Trust & Savings Bank, predecessor in interest of Security-First National Bank of Los Angeles, recorded April 27, 1928, in Book 7115, Page 83, of Official Records of the County



Respondent's Exhibit A—(Continued)  
of Los Angeles, State of California, and LUTHER S. BELL, a preferred stockholder of California Consumers Company,

Plaintiffs,

vs.

PACIFIC PUBLIC SERVICE COMPANY, a corporation, CALIFORNIA CONSUMERS COMPANY, a corporation, JOHN A. BULLARD, JOHN A. BULLARD, as Trustee, CITIZENS NATIONAL TRUST & SAVINGS BANK OF LOS ANGELES, as Trustee, KATE P. CRUTCHER, EDITH W. DAVIS, MABEL S. LOUGHERY, AMELIA SEIBERT, ERIC A. STARKE, YOUNG-CLARKE & COMPANY, a corporation, SAMUEL L. ABBOTT, H. F. ALLEN ESTATE COMPANY, a corporation, BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, as Trustee, BUSH STREET INVESTMENT CO., a corporation, INA CAMPBELL, SUSAN N. FITKIN, THE GUIBERSON CORPORATION, a corporation, HERBERT E. HALL, JEANETTE MEIER HELLER, G. D. LUCY, JAMES H. PIERCE, RED SALMON CANNING CO., a corporation, THOMAS RHODUS, SR., CLARENCE J. WETMORE, CLARENCE J. WETMORE, as Executor, ROBERT T. SHELDON, HARRIET L. SPERRY, JAMES E. WALSH, DEAN WITTER & CO., a corpora-

Respondent's Exhibit A—(Continued)

tion, JACK M. WRIGHTSON, A COMPANY, a corporation, B COMPANY, a corporation, C COMPANY, a corporation, D COMPANY, a corporation, E COMPANY, a corporation, F COMPANY, a corporation, G COMPANY, a corporation, H COMPANY, a corporation, I COMPANY, a corporation, J COMPANY, a corporation, ONE DOE, TWO DOE, THREE DOE, FOUR DOE, FIVE DOE, SIX DOE, SEVEN DOE, EIGHT DOE, NINE DOE, TEN DOE, ELEVEN DOE, TWELVE DOE, THIRTEEN DOE, FOURTEEN DOE, FIFTEEN DOE, SIXTEEN DOE, SEVENTEEN DOE, EIGHTEEN DOE, NINETEEN DOE, TWENTY DOE, TWENTY-ONE DOE, TWENTY-TWO DOE, TWENTY-THREE DOE, TWENTY-FOUR DOE, TWENTY-FIVE DOE, TWENTY-SIX DOE, TWENTY-SEVEN DOE, TWENTY-EIGHT DOE, TWENTY-NINE DOE and THIRTY DOE,

Defendants.

BAUER, MacDONALD,  
SCHULTHEIS & PETTIT,

.....

(Alexander Macdonald

.....

(Fred E. Pettit, Jr.)

.....

(Robert H. Edwards, Jr.)

Attorneys for Plaintiffs.

## Respondent's Exhibit A—(Continued)

## COMPLAINT

(to recover upon behalf of California Consumers Company judgment account dividends unlawfully declared and paid.)

Plaintiffs and each of them complain of the defendants and each of them, and for cause of action allege that:

## I.

Plaintiff Guy L. Goodwin is an individual residing within the City of Los Angeles, County of Los Angeles, State of California. By order of the United States District Court, for the Southern District of California, Central Division, dated December 2, 1933, In Equity, Cause No. 122-C, entitled "Security-First National Bank of Los Angeles, as Trustee, Plaintiff, vs. California Consumers Company, a corporation, Defendant," brought to foreclose the mortgage and trust indenture of California Consumers Company dated as of April 2, 1928, and hereafter more in detail referred to, said Guy I Goodwin was appointed Temporary Receiver on foreclosure of the mortgaged property in said mortgage and trust indenture described and referred to. On said 2nd day of December, 1933, he swore faithfully to perform his duties as such Receiver in said action, and in accordance with the

## Respondent's Exhibit A—(Continued)

provisions of said order dated December 2, 1933, furnished and filed a bond in the sum of Two Hundred Thousand Dollars (\$200,000.00), conditioned upon faithful performance by him of the duties of his office as such Receiver. Since said date he has been and now is the duly qualified, appointed and acting Temporary Receiver on foreclosure of property described and referred to in said mortgage and trust indenture, to-wit, all of the property, real, personal and mixed, of every kind and nature, of the defendant California Consumers Company.

## II.

By the provisions of the order dated December 2, 1933, said Guy L. Goodwin, as Temporary Receiver, is authorized and empowered, among other things, to institute, prosecute and defend, compromise, adjust, intervene in, or become a party to such suits, [104] actions, proceedings at law or in equity, including ancillary proceedings in state or federal courts, as may in the judgment of the Receiver be necessary or proper for the protection, maintenance and preservation of the property and assets of said California Consumers Company and the conduct of its business for the carrying out of the terms and provisions of said order, and in his discretion to compound and settle with all debtors of said California Consumers Company, with persons having



## Respondent's Exhibit A—(Continued)

possession of its property or in any way responsible at law or in equity to said California Consumers Company, upon such terms and in such manner as said Receiver shall deem just and beneficial to said California Consumers Company and its creditors.

## III.

Pursuant to the provisions of said order dated December 2nd the plaintiff Guy L. Goodwin, as such Receiver, took and entered into possession of and still has possession of all of said property, real, personal and mixed, of every kind and nature, of said California Consumers Company.

## IV.

The plaintiff Security-First National Bank of Los Angeles is, and for a period of several years last past has been, a national bank organized and existing under and by virtue of compliance with the laws of the United States and duly empowered to exercise, and exercising, all of the rights and privileges of national trust and savings banks and associations under the laws of the United States.

## V.

By indenture dated as of the 2nd day of April, 1928, recorded the 27th day of April, 1928, in Book 7115, page 83, of Official Records of the County of Los Angeles, on September 18, 1928, in Volume 230, page 1, of Official Records of the County of Ventura, [105] and on October 20, 1928, in Book 1550, page 1, of Deeds, Records of the County of San



## Respondent's Exhibit A—(Continued)

Diego, all in the State of California, California Consumers Company, hereafter more in detail referred to, conveyed to Los Angeles-First National Trust & Savings Bank, hereafter more in detail referred to, as Trustee, all of the right, title and interest of said California Consumers Company in and to any and all premises, property, franchises and rights of every kind and description, real and personal (excepting accounts receivable, bills receivable, cash on hand and in bank, materials and supplies, commodities constituting a whole or any part of stock of merchandise kept for sale, contracts and operating agreements with other companies, leases and leasehold interests, and all shares of stock, bonds and other securities not specifically transferred or assigned to or pledged with said Los Angeles-First National Trust & Savings Bank of Los Angeles, as Trustee), then owned or thereafter acquired by said California Consumers Company, including other and after acquired property as follows, namely, also all other property, real, personal and mixed, which said California Consumers Company then owned and all which said California Consumers Company might thereafter acquire, together with all and singular the tenements, hereditaments, fixtures and appurtenances belonging or in any wise appertaining to the aforesaid property or any part thereof, with the reversion and reversions, remainder and remainders, tolls, rents, revenues, issues, income, product and profits thereof, and all of the estate, right, title, interest and claim whatso-

## Respondent's Exhibit A—(Continued)

ever, at law as well as in equity, which said California Consumers Company then had or might thereafter acquire in and to the aforesaid property and franchises, and every part and parcel thereof. All of said property above referred to and in said indenture described and referred to was thereby conveyed in trust to secure the punctual payment of principal [106] and interest of and the faithful performance of the terms and conditions contained in a series of first mortgage and first lien gold bonds in an aggregate principal sum of Three Million Seven Hundred Fifty Thousand Dollars (\$3,750,000.00) to be issued, sold and delivered by said California Consumers Company, and which said bonds were thereupon and thereafter pursuant to the provisions of said indenture so issued, sold and delivered.

## VI.

Said Los Angeles-First National Trust & Savings Bank was on said 2nd day of April, 1928, and for a long time thereafter, a national bank organized and existing under and by virtue of compliance with the laws of the United States. Plaintiff Security-First National Bank of Los Angeles is its successor in interest and the assignee and successor therefor under the provisions of said trust indenture and is the present Trustee under said provisions thereof.

## VII.

The defendant California Consumers Company above referred to is, and at all times herein men-

## Respondent's Exhibit A—(Continued)

tioned has been, a corporation organized and existing under the laws of the State of Delaware and duly authorized to do and doing business within the State of California.

## VIII.

Plaintiff Luther S. Bell is an individual residing in the City of Los Angeles, County of Los Angeles, State of California, and is the owner and holder of twenty (20) shares of the preferred stock of said California Consumers Company.

Plaintiff Bell is informed and believes, and upon such information and belief alleges, that there are very many other preferred stockholders of said California Consumers Company, said preferred stock being widely held, and that it is impracticable to [107] bring them all before the court as parties plaintiff herein, and that for that reason he brings and joins in this action for the benefit of all other preferred stockholders of said California Consumers Company, the questions herein involved being a common or general interest.

During his ownership of his said stock he has received no dividends thereon.

## IX.

Defendant Pacific Public Service Company is, and at all times herein mentioned has been, a corporation duly organized and existing under and by virtue of compliance with the laws of the State of Delaware and duly authorized to do and doing business within the State of California.

## Respondent's Exhibit A—(Continued)

## X.

Plaintiffs are informed and believe, and upon such information and belief alleges:

That defendant John A. Bullard, as Trustee, is Trustee for J. H. Bullard under a certain agreement dated October 24, 1931.

That defendant Citizens National Trust & Savings Bank of Los Angeles is a national banking association organized and existing under the laws of the United States and is Trustee under its Declaration of Trust No. 5375.

That defendant Young-Clarke & Company is, and at all times herein mentioned has been, a corporation duly organized and existing under the laws of the State of California.

That defendant H. F. Allen Estate Company is a corporation, but under the laws of what state it is organized plaintiffs are not advised.

That defendant Bank of America National Trust & [108] Savings Association is a national banking association organized and existing under the laws of the United States and is Trustee under its Agreement No. 19, dated May 25, 1928, with George P. Beck and Louis M. Beck, of Stockton, California.

That defendant Bush Street Investment Co. is a corporation, but under the laws of what state it is organized plaintiffs are not advised.

That defendant The Guiberson Corporation is a corporation organized and existing under the laws of the State of Delaware and duly authorized to do



## Respondent's Exhibit A—(Continued)

and doing business under the laws of the State of California.

That defendant Red Salmon Canning Co. is a corporation, but under the laws of what state organized plaintiffs are not advised.

Defendant Clarence J. Wetmore, as Executor, is Executor of the Last Will and Testament of Grace C. Richards, deceased.

That defendant Dean Witter & Co. is a corporation organized and existing under the laws of the State of California.

## XI.

Plaintiffs are ignorant of the true names of the defendants A Company, a corporation, B Company, a corporation, C Company, a corporation, D Company, a corporation, E Company, a corporation, F Company, a corporation, G Company, a corporation, H Company, a corporation, I Company, a corporation, J Company, a corporation, One Doe, Two Doe, Three Doe, Four Doe, Five Doe, Six Doe, Seven Doe, Eight Doe, Nine Doe, Ten Doe, Eleven Doe, Twelve Doe, Thirteen Doe, Fourteen Doe, Fifteen Doe, Sixteen Doe, Seventeen Doe, Eighteen Doe, Nineteen Doe, Twenty Doe, Twenty-one Doe, [109] Twenty-two Doe, Twenty-Three Doe, Twenty-Four Doe, Twenty-Five Doe, Twenty-Six Doe, Twenty-Seven Doe, Twenty-Eight Doe, Twenty-Nine Doe and Thirty Doe. Said defendants are designated herein by fictitious names. When their true names are discovered or when the true name or



Respondent's Exhibit A—(Continued)  
names of any of them are discovered this pleading  
and proceeding will be amended accordingly.

## XII.

Defendants A Company, a corporation, B Company, a corporation, C Company, a corporation, D Company, a corporation, E Company, a corporation, F Company, a corporation, G Company, a corporation, H Company, a corporation, I Company, a corporation, and J Company, a corporation, are each corporations organized and existing under the laws of the State of California or of other states of the United States.

## XIII.

Plaintiffs are informed and believe, and upon such information and belief allege:

That at all times since prior to the 5th day of May, 1929, the defendants Pacific Public Service Company, a corporation, A Company, a corporation, B Company, a corporation, C Company, a corporation, D Company, a corporation, E Company, a corporation, One Doe, Two Doe, Three Doe, Four Doe and Five Doe have been the owners and holders of all issued and outstanding common stock of California Consumers Company and that since the early portion of the year 1929, the exact date being unknown to the plaintiffs herein, the defendant Pacific Public Service Company, a corporation, has been and still is the sole owner of all issued and outstanding common stock of said California Con-

sumers Company, now aggregating twenty-five thousand (25,000) shares of such common stock.

#### XIV.

Plaintiffs are informed and believe, and upon such information and belief allege, that all of the defendants herein named have been and are owners and holders of not less than seventy-two (72) shares each of the issued and outstanding preferred stock of California Consumers Company and that each of such defendants has received in the aggregate Two Thousand Dollars (\$2,000.00) or more as dividends upon such preferred stock during the ownership by each said defendant thereof, the aggregate number of shares of outstanding preferred stock at the date hereof being fifteen thousand three hundred forty-three (15,343) shares; that plaintiffs are uninformed as to the exact dates and number of shares acquired by each of said defendants; and that such information can be adduced only after a detailed accounting of the stock records of California Consumers Company, which records are in the possession and control of said company and its Board of Directors.

#### XV.

Plaintiffs are informed and believe, and upon such information and belief allege, that on outstanding preferred stock of California Consumers Company dividends were declared and paid at the dates and in aggregate amounts as follows:

7/1/28	\$ 26,250.00
10/1/28	26,250.00

## Respondent's Exhibit A—(Continued)

1/1/29	26,250.00
4/1/29	26,250.00
7/1/29	26,250.00
10/1/29	26,278.00
1/1/30	27,039.25
4/1/30	27,125.00
7/1/30	27,153.00
10/1/30	27,483.75
1/1/31	27,676.25
4/1/31	27,702.50
7/1/31	27,566.00
10/1/31	27,583.50
1/1/32	27,454.00
4/1/32	27,464.50
totalling in all the sum of	\$431,775.75

## XVI.

Plaintiffs are informed and believe, and upon such information and belief allege, that dividends were declared and paid on issued and outstanding common stock of said California Consumers Company upon the dates and in aggregate amounts as follows:

5/ 5/29	\$ 75,000.00
8/23/29	90,000.00
12/20/29	206,250.00
4/29/30	18,000.00
4/31/30	10,000.00
9/26/30	75,000.00
12/31/30	75,000.00
9/30/31	50,000.00
totalling in all the sum of	\$599,250.00

## Respondent's Exhibit A—(Continued)

## XVII.

Plaintiffs are informed and believe, and upon such information and belief allege, that at the times of the declaration and of the payment of the dividends referred to in paragraphs XV and XVI hereof and at each and all of said times, and throughout its entire corporate existence, said California Consumers Company had no surplus out of which such dividends or any thereof might lawfully be declared and paid, or declared or paid; that at all of said times, and at all times throughout its corporate existence it had a corporate deficit; that at none of said times, either when said dividends were declared and paid or at any time during its corporate existence, were its net assets in excess of its capital and that at all of said times the capital of said California Consumers Company has been and has remained diminished by depreciation in the value of its properties, by losses, and otherwise, to an amount less than the aggregate amount of the capital represented by the issued and outstanding shares of all classes having a preference upon the distribution of assets, and that such deficiency has not at any time been repaired; and that such corporate deficit has never been less than approximately Two Hundred [112] Thousand Dollars (\$200,000.00), and from time to time has exceeded half a million dollars.

## XVIII.

Plaintiffs are informed and believe, and upon such information and belief allege:

## Respondent's Exhibit A—(Continued)

That at all times prior to the 1st day of May, 1932, and when the dividends referred to in paragraphs XV and XVI hereof were declared and paid, the sole voting power and rights of said California Consumers Company were vested in the owners and holders of its common stock; that since a date in the year 1929, the exact date of which is unknown to plaintiffs, Pacific Public Service Company, a corporation, has been the sole owner of all of the issued and outstanding common stock of California Consumers Company.

That at all times since said Pacific Public Service Company became the sole owner of all issued and outstanding common stock it has dominated and controlled said California Consumers through the election of members of the Board of Directors of said California Consumers Company, that at all said times the members of the Board of Directors of California Consumers Company have been substantially identical with the members of the Board of Directors of Pacific Public Service Company and have been officers and/or directors of said last mentioned company; and that the declaration of dividends upon the common stock of said California Consumers Company was directed and controlled by such sole common stockholder, to-wit, Pacific Public Service Company.

## XIX.

Plaintiffs Guy L. Goodwin, as Receiver, and  
[113] Security-First National Bank of Los Angeles,



## Respondent's Exhibit A—(Continued)

as Trustee, are informed and believe, and upon such information and belief allege, that the assets of California Consumers Company, which are subject to the lien of the indenture hereinabove referred to, if sold on foreclosure sale would yield an amount not more than one-half the present indebtedness of said California Consumers Company, as reflected by outstanding bonds, said bond indebtedness, including principal and interest, amounting at the present time to approximately the sum of Three Million Four Hundred Ninety Six Thousand Five Hundred Dollars (\$3,496,500.00); that said Trustee would upon any such sale of assets under foreclosure be entitled to a deficiency judgment for the amount thereof, which would total materially in excess of One Million Dollars (\$1,000,00.00); that whatever rights there may be in California Consumers Company to recover dividends unlawfully paid as herein referred to, are assets of said California Consumers Company, to the avails of which or to a participation in which the plaintiff Receiver and plaintiff Trustee are lawfully entitled for the benefit of the owners and holders of bonds issued under the provisions of the indenture mentioned; that said California Consumers Company is insolvent; that such indebtedness on the 1st day of October, 1933, amounted to in excess of Three Million Five Hundred Thousand Dollars (\$3,500,000.00); and that said company had been insolvent for some time prior thereto the exact time during which and

Respondent's Exhibit A—(Continued)  
since when it had been insolvent being unknown to the plaintiffs herein.

## XX.

Plaintiffs are informed and believe, and upon such information and belief allege, that by reason of the facts set forth in paragraph XVII hereof said declarations and payments of dividends as mentioned in paragraph XV and XVI hereof were invalid and unlawful, and that plaintiffs upon behalf of said California [114] Consumers Company are entitled to require that the amounts so paid be recovered from the payees thereof, respectively, together with interest thereon at the legal rate from the date of each such dividend disbursement.

## XXI.

Dominated and controlled by its sole common stockholder since 1929, to-wit, Pacific Public Service Company, California Consumers Company has failed and refused to bring any such action. Accordingly, this action is brought by the plaintiffs herein upon behalf of said California Consumers Company. Any demand that it bring such action would have been unavailing and useless for the reason that the members of the Board of Directors were at all times substantially all and at some time entirely all members of the Board of Directors of or officers of said Pacific Public Service Company, against which company, among other defendants, a recovery is herein sought.

## Respondent's Exhibit A—(Continued)

## XXII.

Only since the appointment of the Receiver herein on the 2nd day of December, 1933, have the facts herein alleged been ascertained. His appointment resulted from the foreclosure action above mentioned, brought by the plaintiff Trustee after the bond default above referred to. But notwithstanding the facts set forth in the next preceding paragraph the plaintiffs herein served upon said California Consumers Company and upon its Board of Directors, on the 28th day of December, 1933, a request and demand, in words and figures as follows:

“To California Consumers Company,  
225 Bush Street,  
San Francisco, California,  
230 West Jefferson Street,  
Los Angeles, California, and

To The Board of Directors thereof:

The undersigned, (a) Guy L. Goodwin, the duly appointed, qualified and acting Temporary Receiver on [115] foreclosure of mortgaged property pursuant to order dated the 2nd day of December, 1933, in that certain action pending in the District Court of the United States, for the Southern District of California, Central Division, entitled “Security-First National Bank of Los Angeles, as Trustee, Plaintiff, vs. California Consumers Company, a corporation, Defendant,” Equity No. 122-C, (b) Security-First National Bank of Los Angeles, as

## Respondent's Exhibit A—(Continued)

Trustee under the provisions of that certain Trust Indenture dated as of the 2nd day of April, 1928, between California Consumers Company and Los Angeles-First National Trust & Savings Bank, predecessor of said Security-First National Bank of Los Angeles, recorded April 27, 1928, in Book 7115, page 83, of Official Records of the County of Los Angeles, the foreclosure of the lien of which indenture is the purpose, among others, of the action above referred to and (c) Luther S. Bell, an owner and holder of twenty (20) shares of the preferred stock of California Consumers Company, hereby, jointly and severally, request and demand that forthwith you demand, sue for, collect and receive (1) from Pacific Public Service Company, your present sole common stockholder, and any and all other common stockholders from time to time heretofore, the amount of all dividends upon common stock of California Consumers Company heretofore declared and paid to them and/or to any of them, amounting in the aggregate to approximately Six Hundred Thousand Dollars (\$600,000.00), plus interest at the legal rate upon each dividend disbursement from the respective date of each such disbursement, and (2) from the owners and holders, past and present, of all shares of preferred stock of California Consumers Company, the amount of all dividends thereon heretofore declared and [116] paid to each such owner and holder respectively during his, her and/or its ownership thereof, amounting in the aggregate to approximately Four Hundred



## Respondent's Exhibit A—(Continued)

Thirty-five Thousand Dollars (\$435,000.00), plus interest at the legal rate upon each dividend disbursement from the respective date of each such disbursement.

This request and demand is made for the following reasons and upon the following grounds, namely: (a) That at no time during the corporate existence of California Consumers Company has it had a surplus out of which such dividends or any thereof might lawfully be declared and/or paid; (b) that at all times during its corporate existence it has had a corporate deficit; (c) that at no time during its corporate existence have its net assets been in excess of its capital, and (d) that the capital of said California Consumers Company has at all times been and has remained diminished by depreciation in the value of its properties, by losses, and otherwise, to an amount less than the aggregate amount of the capital represented by the issued and outstanding shares of all classes having a preference upon the distribution of assets, and that such deficiency has not at any time been repaired.



Respondent's Exhibit A—(Continued)  
Los Angeles, California, December 28th, 1933.

GUY L. GOODWIN

Temporary Receiver appointed by order dated December 2, 1933, in said Equity Case No. 122-C.

SECURITY-FIRST NATIONAL  
BANK OF LOS ANGELES,  
as Trustee,

[Seal]      By W. N. BUCKLIN, Jr.  
Its Vice-President.

Attest:

C. C. HOGAN

Asst. Secretary.

LUTHER S. BELL

Preferred Stockholder. [117]

Said demand has not been complied with, nor has any reply thereto been received.

### XXIII.

All books and records of said California Consumers Company relating to declaration of dividends and all of its stock books and records are in the possession and custody of said California Consumers Company and its Board of Directors. Plaintiffs have no exact or detailed information as to the individual amounts and the individual dates on which such dividends were paid to individual common stockholders and individual preferred stockholders, parties defendant herein, except as herein set forth. In order to arrive at exact facts with respect thereto it is necessary that an accounting be had, in the interests of equity and fairness to

Respondent's Exhibit A—(Continued)

California Consumers Company, its bondholders, other secured creditors, unsecured creditors, and preferred stockholders entitled to share in the ultimate distribution of its assets, and that all such books and records be made available to the plaintiffs herein.

XXIV.

By assignment made, executed and delivered the 1st day of December, 1933, all accounts receivable, bills receivable, cash on hand and in bank, materials and supplies, commodities constituting a whole or any part of stock of merchandise kept for sale, contracts and operating agreements with other companies, leases and leasehold interests, and all shares of stock, bonds and other securities not specifically transferred or assigned to or pledged with the Trustee upon the execution and delivery of the indenture above referred to, as mentioned in paragraph V hereof, were transferred, assigned and delivered to the plaintiff Security-First National Bank of Los Angeles, as Trustee, in accordance with the provisions of said indenture, namely, that upon the occurrence of [118] an event of default all such excepted assets shall become and be subject to the lien of said indenture, and be forthwith delivered to the Trustee. Said formerly excepted assets are now and since said 1st day of December, 1933, have been subject to the lien of said indenture.

XXV.

Plaintiffs herein hereby offer and agree to do

Respondent's Exhibit A—(Continued)  
and perform whatever may be equitable and just in the premises.

Wherefore, plaintiffs pray:

1. That an accounting by each of the defendants herein, other than the defendant California Consumers Company, of all dividends paid to each such defendant upon the common stock and upon the preferred stock of California Consumers Company owned and held by each such defendant respectively, showing amounts and dates of payment, be ordered by this Court;

2. That defendant California Consumers Company do have and recover from defendants Pacific Public Service Company, A Company, B Company, C Company, D Company, E Company, One Doe, Two Doe, Three Doe, Four Doe and Five Doe the amount of all dividends paid to them respectively upon the common stock of said California Consumers Company, amounting in the aggregate to approximately the sum of Six Hundred Thousand Dollars (\$600,000.00), and not less than the sum of Five Hundred Ninety Nine Thousand Two Hundred Fifty Dollars (\$599,250.00), plus interest at the legal rate upon each such dividend disbursement from the respective date of each such disbursement to the time of trial herein;

3. That defendant California Consumers Company do have and recover from each and all of the defendants herein, other than itself as defendant, the amount of all dividends upon preferred stock

## Respondent's Exhibit A—(Continued)

of California Consumers Company paid to each such defendant respectively during his, her and/or its ownership thereof, amounting [119] in the aggregate to approximately Four Hundred Thirty Five Thousand Dollars (\$435,000.00), and not less than the sum of Four Hundred Thirty One Thousand Seven Hundred Seventy Five & 75/100 Dollars (\$431,775.75), plus interest at the legal rate upon each dividend disbursement from the respective date of each such disbursement to the time of trial herein;

4. That the plaintiffs be allowed and that they recover from defendants all of their costs and expenses attendant upon or incidental to this proceeding; and

5. That the plaintiffs and said defendant California Consumers Company have all such other and further relief as may be meet and just in the premises.

O'MELVENY, TULLER &  
MYERS,

WALTER K. TULLER,

PIERCE WORKS,

GRAHAM L. STERLING, Jr.

BAUER, MACDONALD,

SCHULTHEIS & PETTIT,

ALEXANDER MACDONALD,

FRED E. PETTIT, Jr.,

ROBERT H. EDWARDS, Jr.,

Attorneys for Plaintiffs [120]

## Respondent's Exhibit A—(Continued)

State of California

County of Los Angeles—ss.

Guy L. Goodwin, as Temporary Receiver on foreclosure of mortgaged property, under Order dated December 2, 1933, In Equity, Cause No. 122-C, in the United States District Court, for the Southern District of California, Central Division, being first duly sworn, deposes and says: That he is one of the plaintiffs in the above entitled action; that he has read the foregoing Complaint and knows the contents thereof, and that the same is true of his own knowledge, except as to the matters which are therein stated on information and belief, and as to those matters that he believes it to be true.

GUY L. GOODWIN,

Subscribed and sworn to before me this 29th day of December, 1933.

[Seal]

KATIE V. TADLOCK,

Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: Filed, 3:56 p. m., Dec. 29th, 1933.



PETITIONERS' EXHIBIT NO. 2

In the Superior Court of the State of California  
in and for the County of Los Angeles

No. 367553

GUY L. GOODWIN, as Temporary Receiver, etc.,  
et al.,

Plaintiff,

vs.

PACIFIC PUBLIC SERVICE COMPANY, a  
corporation, et al.,

Defendants.

STIPULATION

It Is Hereby Stipulated by and between O'Melveny, Tuller & Myers, and Bauer, Macdonald, Schultheis & Pettit, attorneys for the above named plaintiffs, and Lawler & Degnan, attorneys for the following named defendants, Pacific Public Service Company, California Consumers Company, and Bush Street Investment Company, that the defendants so named do hereby enter their appearance in the above entitled action, and that the time of said defendants within which to answer, plead or otherwise move, as it may be advised, to plaintiffs' complaint on file herein, is hereby extended until thirty (30) days after service upon said Lawler & Degnan of written notice to so plead.

It Is Further Stipulated and Agreed that plaintiffs need not bring the above action to trial within two years from the filing of the complaint in the above matter.

Dated September 24th, 1935.

BAUER, MACDONALD,  
SCHULTHEIS & PETTIT

By /s/ ALEXANDER MACDONALD,  
/s/ FRED E. PETTIT, Jr.  
/s/ ROBERT H. EDWARDS

O'MELVENY, TULLER &  
MYERS

By /s/ WALTER K. TULLER,  
/s/ PIERCE WORKS,  
/s/ GRAHAM L. STERLING, Jr.

Attorneys for Plaintiffs

LAWLER & DEGNAN

By /s/ M. PHILIP DAVIS

Attorneys for Defendants Pacific Public Service  
Company, California Consumers Company, and  
Bush Street Investment Company.

I hereby certify that the foregoing instrument  
is a correct copy of the original record in this office  
same having been filed Sep. 25, 1935.

Attest November 23, 1943.

[Seal] J. F. MORONEY,

County Clerk and Clerk of the Superior Court of  
the State of California in and for the County  
of Los Angeles.

/s/ M. JACKSON,  
Deputy.

[Endorsed]: T.C.U.S. Filed Nov. 26, 1943.

The Tax Court of the United States

Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

SUPPLEMENTAL STIPULATION OF FACT

It is mutually stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true in this proceeding without prejudice to the right of either party to offer further evidence not inconsistent with the facts herein stipulated and subject further to the right of either party to object to any of the facts herein stipulated upon the grounds of immateriality.

1. Petitioner's basis for the 25,000 shares of common stock of the California Consumers Company described in paragraph 7 of the stipulation of fact herein was \$6,000.

Dated San Francisco, California, September 29,  
1944.

G. S. BORDEN  
SIGVALD NIELSON  
SCOTT C. LAMBERT  
Counsel for Petitioner.

J. P. WENCHEL  
Chief Counsel, Bureau of In-  
ternal Revenue, Counsel for  
Respondent.

[Endorsed]: T.C.U.S. Filed Oct. 13, 1944. [124]

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The Tax Court of the United States  
Pacific Public Service Company, Petitioner, v.  
Commissioner of Internal Revenue, Respondent.  
Docket No. 2159. Promulgated February 8, 1945.

### FINDING OF FACT AND OPINION

Cancellation of common stock and exchange of bonds, preferred stock, and demand note for securities of new corporation in 77B proceeding, held to result in tax-free exchange and consequent carry-over of old basis of the bonds and preferred stock but not of the common stock and demand note.

Scott C. Lambert, Esq., Granville S. Borden, Esq., and Sigvald Nielson, Esq., for the petitioner.  
Harold D. Thomas, Esq., for the respondent.

This proceeding was brought for a redetermination of a deficiency in petitioner's income tax for

the year 1940 in the amount of \$7,343.21. Petitioner claims an overpayment of tax for that year in the amount of \$30,488.15.

A claimed additional deduction of \$873.40 for capital stock tax is conceded by respondent.

The question presented relates to the basis of securities sold by petitioner in the taxable year which had been obtained pursuant to a reorganization under section 77B of the Bankruptcy Act.

The case was presented upon stipulation, supplemental stipulation, and testimony adduced at the hearing. Those facts hereinafter appearing which are not from the stipulation are otherwise found from the record.

### FINDINGS OF FACT

The stipulated facts are hereby found accordingly.

Petitioner is a corporation organized under the laws of the State of California, with its principal office in San Francisco. Its income tax return for the year 1940 was filed with the collector of internal revenue for the first California district.

On September 25, 1940, and on October 7, 1940, petitioner sold to Turner Poindexter & Co. of Los Angeles all of its bonds and shares of stock in California Consumers Corporation for amounts aggregating [125] \$19,654.85. The sales were arm's-length transactions between a willing buyer and a willing seller.

The amounts received for each, the cost basis claimed, and the loss claimed by petitioner on its return for the taxable year were as follows:



Item	Amount received	Cost basis claimed on return	Loss claimed on return
\$75,000 principal amount of bonds with participating certificates for 600 shares of stock held by voting trustees .....	\$18,750.00	*\$54,877.66	\$36,181.38
1,353 shares stock .....	263.82	51,001.75	50,737.93
3,287.5 shares stock .....	641.03	6,246.25	5,605.22
Total.....	19,654.85	112,125.66	92,524.53

\* Expense of \$53.72 was also claimed.

In arriving at the cost basis of the 3,287.5 shares on the return petitioner used a value of \$1.90 per share.

In the petition, petitioner claims a cost basis of \$478,270 (the amount of the note hereinafter referred to) for the 3,287.5 shares above referred to.

California Consumers Co. (hereinafter sometimes called Consumers), a Delaware corporation, was organized on March 20, 1928. It operated both directly and indirectly, through various subsidiary companies, an extensive ice and cold storage business in southern California. Operations by Consumers during the years 1932 and 1933 resulted in losses. On October 1, 1933, Consumers defaulted in the payment of the semiannual interest due on its first mortgage series A bonds and on December 1, 1933, it was insolvent. Accordingly, on December 3, 1933, the trustee under the indenture securing the bonds filed a bill of complaint for the foreclosure of the indenture in the United States District Court at Los Angeles and requested the appointment of a receiver of the properties ancillary

to and pending the outcome of the foreclosure action. On that date the court appointed a receiver, and thereafter and until the consummation of the March 1, 1935, agreement the properties were operated by the receiver.

The plan of reorganization set forth in the agreement dated March 1, 1935, was formulated and composed by committees representing the bondholders, the preferred stockholders, and petitioner as unsecured creditor of Consumers. The plan, provisions, and terms of this agreement were confirmed by the United States District Court for the Second District of California, Second Division, on September 30, 1935, and carried out and consummated in 1935, under the provisions of section 77B of the Federal Bankruptcy Act. [126]

In 1928 petitioner acquired 15,000 shares of common stock of Consumers, which constituted at that time all the issued and outstanding shares of common stock. On June 10, 1930, petitioner acquired 10,000 additional shares of common stock by reason of a declaration of a dividend of 10,000 shares on the 15,000 shares. Petitioner thereafter, until the time of the transaction covered by the agreement dated March 1, 1935, held all the issued and outstanding common stock of Consumers, consisting of 25,000 shares. The basis for these 25,000 shares was \$6,000.

At intervals between April 1931 and July 1933 petitioner acquired a total of 902 shares of preferred stock of Consumers at a cost of \$51,001.75 and bonds of the company in the principal amount

of \$75,000 at a cost of \$54,877.66. These purchases were made on the open market and the stock and bonds were held by petitioner up to the time of the transaction covered by the March 1, 1935, agreement.

Prior to May 31, 1933, petitioner had made cash advances to Consumers which totaled \$478,270. On that date Consumers made a promissory note, payable on demand and bearing interest at 5 per cent per annum, in the amount of \$478,270 in favor of petitioner, evidencing an indebtedness of that amount. Prior to March 1, 1935, petitioner had not received any payment on account of this indebtedness.

Operations by Consumers resulted in losses and in December 1933 it was insolvent. Excepting liabilities to the subsidiaries and affiliated companies, its liabilities (exclusive of capital stock) at that time were as follows:

\$3,496,500 principal amount First Mortgage Series "A" bonds dated April 2, 1928, of which petitioner held \$75,000 principal amount;

\$478,270 unsecured promissory note held by petitioner.

As of December 2, 1933, Consumers had stock outstanding as follows:

15,343 shares \$7 cumulative preferred stock, no par value, of which petitioner held 902 shares;

25,000 shares of no par common stock, held by petitioner.

All the interested parties accepted the plan of reorganization set forth in the agreement dated

March 1, 1935. In accordance with the provisions of the plan requiring a new corporation, California Consumers Corporation (hereinafter sometimes called the new company) was organized in 1935, under the laws of the State of California, and in that year acquired the properties referred to in the plan, which constituted all or substantially all of the properties which had been owned and operated by Consumers, and issued \$3,496,500 principal amount of bonds and 54,274 shares of stock as provided in article III of the plan. The parties who prior to the plan held bonds, stock, and the [127] note of the company, received pursuant to the plan the following interests in the new company:

Holding in Consumers	Interest in new company received
\$3,496,500 principal amount of bonds (of which \$75,000 principal amount was held by petitioner)	\$3,496,500 principal amount of bonds and 27,972 participating certificates for 27,972* shares of stock
15,343 shares no par value preferred stock (of which 902 shares were held by petitioner)	23,014.5 shares
\$478,270 unsecured demand note (held by petitioner)	3,287.5 shares
25,000 shares common stock (held by petitioner)	Nothing
Total.....	\$3,496,500 bonds; 54,274 shares

\*Stipulated, but apparently in error, as 29,972 shares.

By reason of its respective holdings of bonds and stock and the note of Consumers, petitioner,



as a result of the consummation of the plan, received the following:

Holdings in Consumers	Interest in new company received
\$75,000 principal amount of bonds	\$75,000 principal amount of bonds with participating certificates for 600 shares of common stock held by voting trustees
902 shares preferred stock	1,353 shares of common stock
\$478,270 note—unsecured	3,287.5 shares of common stock
25,000 shares common stock	Nothing

The bonds and stock of the new company which petitioner received were the bonds and stock which petitioner sold in the taxable year.

The bonds of Consumers had been first mortgage bonds, dated April 1, 1928, maturing in twenty years, but subject to earlier redemption upon payment of principal and accrued interest, computed on a specified formula according to the date of redemption.

The bonds of the new company were to be dated as of such date as the bondholders' committee should designate and, subject to certain provisions allowing earlier redemption, matured twenty years from their date. They bore an interest rate of 5 per cent, of which 3 per cent was designated "fixed interest" (i.e., unconditionally due), payable in semiannual installments, and the remaining 2 per cent designated as "income interest" payable in annual installments only if and to the extent that the net income of the new company and its subsidiaries on a consolidated basis for the twelve-



month period ended two months prior to the interest date was available for the payment of interest. The bonds further provided that "Net income shall be deemed to be available for the payment of income interest only if the payment thereof [128] will not reduce the net working capital of the new corporation and its subsidiaries \* \* \*, to an amount insufficient for the needs of the business as determined from time to time by the board of directors and, so long as the voting trust agreement is in existence, approved by at least a majority of the voting trustees."

Income interest not earned and available in any annual period did not accumulate. The new bonds also contained provisions for establishment of a sinking fund. Such bonds were, according to the plan, secured by a new trust indenture upon all of the properties acquired. The bondholders' committee was given the right to select the trustee under the new indenture.

Paragraph 7 of article IV of the plan contains the following:

The new trust indenture shall provide that with the consent of the holders of seventy-five per cent (75%) in principal amount of new bonds then outstanding:

(a) The new trust indenture may be released and the new bonds satisfied (but only with the written consent of the Commissioner of Corporations of the State of California so long as there is such a commissioner) upon payment or delivery

to the trustee for the benefit of the holders of all the new bonds then outstanding, of a consideration (which may be money, securities or any other consideration), which consideration may be less than the principal amount of the new bonds then outstanding;

(b) With the consent of the new corporation and the trustee, any of the terms and provisions of the new trust indenture or the new bonds may be altered, eliminated or supplemented; or

(c) The new trust indenture may be subordinated to a new mortgage or trust deed or other encumbrance for such purposes and in such amount as such percentage of the holders of the new bonds then outstanding shall approve.

The plan also provided for the dismissal, with prejudice to all parties plaintiff, of a dividend suit filed December 29, 1933, in the Superior Court of California against petitioner, seeking the recovery of the amount of certain dividends alleged to have been illegally declared and paid on both preferred and common stock of Consumers, in the sum of approximately \$1,000,000.

Petitioner has never claimed any portion of the unsecured indebtedness of Consumers as partially or wholly worthless in any of its income tax returns, nor has petitioner received any tax benefit through bad debt deductions with respect thereto. No part of petitioner's cost of preferred stock and bonds of Consumers or of its common stock and bonds of the new company has been claimed or

allowed as a deduction or otherwise in any tax return filed by petitioner prior to 1940.

Petitioner reported a net loss on its Federal income tax returns for 1933, 1934, and 1935, and no tax has been paid by petitioner for those years.

As of December 31, 1933, petitioner wrote down its investment in the bonds of Consumers to \$15,000, petitioner's estimate of their fair market value as of that date, and wrote down the balance of its investments and note to \$1.

### OPINION.

Opper, Judge: In order to compute the deductible loss sustained by petitioner upon a sale in the instant tax year it becomes necessary to fix a basis for the securities which it sold. This in turn involves the question whether the transaction by which petitioner received the stock through a 77B reorganization in exchange for certain interests in a predecessor company was such that petitioner's loss was then recognizable and a new basis acquired, or whether, as petitioner contends, it retained its original basis. This is the sole issue.

The nonrecognition is claimed under three theories—first, that it was an exchange of property for stock under section 112 (b) (5); second, that it was an exchange of stock or securities for stock or securities in a reorganization; and, third, that it is in any event covered by the new provisions,<sup>1</sup>

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<sup>1</sup>Section 112 (1):

“(1) General Rule.—No gain or loss shall be recognized upon an exchange consisting of the

particularly section 112 (1), added by the Revenue Act of 1943.

It seems clear at the outset that this could not have been an exchange under 112 (b) (5). That section requires an identity of interest before and after the exchange, as well as an ownership or control of 80 per cent in the same persons. It is stipulated that prior to the 77B reorganization the old company was insolvent. It might follow from

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relinquishment or extinguishment of stock or securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (b) (10) [under section 77B of the National Bankruptcy Act], in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.

“(2) Exchange Occurring in Taxable Years Beginning Prior to January 1, 1943.—If the exchange occurred in a taxable year of the person acquiring such stock or securities beginning prior to January 1, 1943, then, under regulations prescribed by the Commissioner with the approval of the Secretary, gain or loss shall be recognized or not recognized——

“(A) to the extent that it was recognized or not recognized in the final determination of the tax of such person for such taxable year, if such tax was finally determined prior to the ninetieth day after the date of the enactment of the Revenue Act of 1943; or

“(B) in cases to which subparagraph (A) is not applicable, to the extent that it would be recognized or not recognized under the latest treatment of such exchange by such person prior to December 15, 1943, in connection with his tax liability for such taxable year.”



this that the creditors would then step into the shoes of the stockholders and at least upon the institution of the receivership would so far succeed to the entire proprietary interest in the debtor that a delivery to them of all of the stock of the reorganized corporation would satisfy the requirements of identity of interest established by 112 (b) (5). *Helvering v. Cement Investors, Inc.*, 316 U. S. 527. But here the creditors, who on that theory would be entitled to all of the proprietary interest in the new corporation and its assets, and certainly at least to a controlling interest, acquired but 48 per cent of the new stock and the secured creditors but 42 per cent, petitioner as holder of an unsecured demand note obtaining the other 6. The preferred shareholders, who on the insolvency theory would be regarded as wiped out, obtained a majority interest. And it will not do to say that the insolvency theory might be disregarded, for that is the sole reason advanced for the complete elimination of the common shareholders.

By the same token, of course, the requirement that the owners of the property transferred shall retain a control of not less than 80 per cent likewise acts as a bar to the application of 112 (b) (5). Not only did the creditors of the insolvent old corporation, the presumptive owners of all of its property, acquire less than an 80 per cent interest in the transferee; they received, as has been pointed out, less than a 50 per cent interest. If the financial condition of the old company was such that the interests in its assets were properly allocated



as between creditors and preferred shareholders—a finding which incidentally would contradict the stipulated fact of insolvency<sup>2</sup>—that conclusion would have to appear from evidence of the assets and liabilities involved. In the absence of such evidence, it can not be assumed that the exchange in question was nontaxable under 112 (b) (5). *Bunker Hill & Sullivan Mining & Concentrating Co.*, 1 T. C. 1057, 1074.

Consideration of section 112 (b) (3) requires a separation of the various interests involved. Petitioner acted in four capacities. It was the owner of all of the common stock of the old company, as well as some of the preferred. It held its unsecured demand note for almost half a million dollars. And it owned some of the bonds. Under the plan of reorganization petitioner received blocks of common stock of the new company, the only class issued, in exchange for its bonds and preferred stock, and an additional common stock interest in exchange for the demand note. It received nothing for its common stock. This we think completely eliminates the latter as a part of petitioner's retained basis. Section 112 (b) (3) relates exclusively to exchanges. Since the common stock was exchanged for nothing, the loss was complete at that time. No part of petitioner's original basis

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<sup>2</sup>“\* \* \* The full priority rule of *Northern Pacific R. Co. v. Boyd*, 228 U. S. 482 \* \* \* gives creditors, whether secured or unsecured, the right to exclude stockholders entirely from the reorganization plan when the debtor is insolvent. \* \* \*” *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U. S. 179.

for the common stock may hence be included as any part of its retained basis for the stock of the new company.

As to the exchange of bonds for bonds and common stock and of preferred stock for common, no question arises concerning the existence of an exchange and, since the old bonds and preferred stock were clearly securities of the old company, that portion of the requirements of section 112 (b) (3) is met. There might have been some doubt whether the exchange was the result of a statutory reorganization under the principle of *Helvering v. Southwest Consolidated Corporation*, 315 U. S. 194, and *Helvering v. Cement Investors, Inc.*, *supra*. But, as will subsequently appear, this factor has been eliminated by the 1943 amendment. The consequence is that the claimed loss on that part of the new stock and bonds acquired in exchange for the bonds and for the preferred stock may be allowed.

When, however, we come to the exchange of the unsecured demand note for additional stock in the new company, we are met with the difficulty that the section requires an exchange of stock or securities for other stock or securities. It is clear that the demand note was not stock. It appears to be equally clear that it was not of sufficient dignity to be considered a security. *Bunker Hill & Sullivan Mining & Concentrating Co.*, *supra*; *Commissioner v. Sisto Financial Corporation* (C. C. A., 2d Cir.), 139 Fed. (2d) 253. No case has been found where a tax-free exchange under section 112 (b) (3) was held to have resulted from the exchange of a de-

mand note. The inclusion of such an exchange in the entire plan, like the payment of cash, might not prevent that section from applying to exchanges otherwise encompassed within the described class of transactions. See *United Gas Improvement Co.*, 47 B. T. A. 715; *affd.* (C. C. A., 3d Cir.), 142 Fed. (2d) 216; *certiorari denied*, — U. S. — (Oct. 9, 1944). And long term notes, especially where a number of them are outstanding, may represent such an interest as to be considered securities. *Burnham v. Commissioner* (C. C. A., 7th Cir.), 86 Fed. (2d) 776; *certiorari denied*, 300 U. S. 683; *Commisisoner v. Huntzinger* (C. C. A., 10th Cir.), 137 Fed. (2d) 128. But to hold that a short term or demand note is a security in the face of such cases as *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U. S. 462, construing the same word in the same section and holding that short term notes “were not securities within the intendment of the Act,” seems to us unjustifiable.

*United Gas Improvement Co.*, *supra*, is not to the contrary. There the opinion on review observes:

\* \* \* From what we have already pointed out, it seems clear that U. G. I.’s economic interest in Nashville continued uninterrupted throughout. After the reorganization, just as before, U. G. I. was the substantial owner of Nashville.

\* \* \* \* \*

\* \* \* In substantial effect, the cancellation of the debt was but a contribution by the sole owner of the reorganized company to the capital of the

company \* \* \* By just so much as U. G. I. thus contributed was its stock interest in the reorganized company benefited. \* \* \*

Here petitioner may either be regarded as the sole stockholder prior to the reorganization, but that interest was wiped out by it, or it may be regarded as a creditor, in which event its interest was recognized to the extent of a minor share in the new company's common stock. Viewed from either standpoint, petitioner's release of its unsecured demand note is not comparable to the capital contribution of a sole shareholder such that the receipt of the stock at that time would prevent its deducting as a loss the uncollected portion of the debt. See *Estate of Isadore L. Myers*, 1 T. C. 100, appeal dismissed (C. C. A., 4th Cir.); *Bunker Hill & Sullivan Mining & Concentrating Co.*, *supra*. It follows that neither the basis for the common stock nor the amount represented by the demand note carried over as a part of petitioner's basis for the new stock.

The only change in the situation resulting from the 1943 amendment is, as has been suggested, that any doubt as to the tax-free character of the transaction involving the bonds and preferred stock has been eliminated. That section still requires that there be an exchange of stock or securities which would not include the demand note. It permits, it is true, the relinquishment of an interest, as well as its exchange, but that must be in consideration of the receipt of stock or securities. Thus, petitioner's relinquishment of its common stock with-



out any consideration equally fails to come within the amendment.

There can, however, be little doubt that, whether or not the transaction in question was a reorganization under section 112 (g), it does comply with the requirements of section 112 (l), since there was a 77B proceeding and the new company was employed to carry out the terms of the reorganization there adopted. Respondent insists that the section is inapplicable because it does not appear that petitioner definitely and formally treated the transaction as nontaxable in its prior dealings. We think, however, that failure to deduct the loss on its original return, coupled with the fact that no question has been raised by respondent and no subsequent amendment has been attempted by petitioner, leaves the entire matter in a state of as complete finality as could possibly have been achieved under the circumstances. We do not read respondent's regulations as calling for more. See *James F. Curtis*, 3 T. C. 648.

Decision will be entered under Rule 50. [133]



The Tax Court of the United States

Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Respondent having on March 13, 1945, filed a recomputation of tax for entry of decision as in accordance with the Findings of Fact and Opinion of the Court promulgated February 8, 1945, and hearing having been had thereon on April 18, 1945, at which time the recomputation of respondent was not contested by petitioner, now, therefore, it is

Ordered and Decided: That claim for refund was filed on April 22, 1942, and that there is an overpayment in income tax for the year 1940 in the amount of \$117.82, which amount was paid on December 15, 1941, and within the time provided by section 322(d) of the Internal Revenue Code.

Entered: April 20, 1945.

(Signed) CLARENCE V. OPPER,  
Judge. [134]

In the United States Circuit Court of Appeals for  
the Ninth Circuit

T. C. Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,  
Petitioner on Review,  
vs.

JOSEPH D. NUNAN, JR., Commissioner of In-  
ternal Revenue,  
Respondent on Review.

PETITION FOR REVIEW AND ASSIGN-  
MENTS OF ERROR

To: The Honorable Judges of the United States  
Circuit Court of Appeals for the Ninth Circuit:

Now comes Pacific Public Service Company by  
its attorneys, Felix T. Smith, Sigvald Nielson, Gran-  
ville S. Borden and Scott C. Lambert, and respect-  
fully shows:

I.

JURISDICTION

Petitioner on review, Pacific Public Service Com-  
pany, [135] is a corporation organized under the  
laws of the State of California, with its principal  
office at 225 Bush Street, San Francisco, Califor-  
nia. Petitioner filed its Federal income tax return  
for the calendar year, 1940, with the Collector of  
Internal Revenue at San Francisco, California.  
The office of the Collector is within the jurisdiction  
of the United States Circuit Court of Appeals for

the Ninth Circuit. Your petitioner filed this petition pursuant to the provisions of sections 1141 and 1142 of the Internal Revenue Code.

## II.

### PRIOR PROCEEDINGS

On March 26, 1943, respondent, Commissioner of Internal Revenue, determined a deficiency in income tax for the calendar year 1940 in the sum of \$7,343.21 and sent to your petitioner by registered mail a notice of said deficiency. Thereafter, on June 17, 1943, the petitioner filed a petition with the Tax Court of the United States and therein alleged that there was no deficiency and alleged an overpayment of \$30,488.15. The case was heard and tried before the Tax Court of the United States on November 26, 1943, at San Francisco, California. On February 8, 1945, [136] the Tax Court of the United States promulgated its opinion (4TC No. 87) and on April 20, 1945, entered its decision determining an overpayment in income tax of petitioner in the amount of \$117.82.

## III.

### NATURE OF THE CONTROVERSY

The question involved is the amount of loss sustained by petitioner in 1940 from the sale of bonds and stock of California Consumers Corporation. This question depends in turn upon a determination of the basis of said bonds and stock in the hands of petitioner at the time of their sale in 1940. The determination of petitioner's basis is the sole issue in the case.

The stock and bonds of California Consumers Corporation sold by petitioner in 1940 were acquired in 1935, pursuant to a reorganization under section 77B of the Bankruptcy Act. In 1933, in consequence of a default in interest payment on its first mortgage bonds, California Consumers Company became insolvent and the trustee started foreclosure proceedings in the Federal District Court. The Court appointed a receiver who operated the properties until 1935 when the plan of reorganization, formulated and composed [137] by committees representing the bond holders, preferred stock holders and petitioner as unsecured creditor, was consummated by the Court.

Under the terms of the reorganization plan, petitioner relinquished its shares of common stock of the insolvent company and exchanged its bonds, preferred stock and unsecured note of the insolvent company in consideration of the receipt of new bonds and stock of the California Consumers Corporation.

Respondent in his notice of deficiency and before the Tax Court contended that the reorganization exchange in 1935 gave rise to gain or loss to petitioner and petitioner's basis for the bonds and stock of the new company was the fair market value of such securities at the time of acquisition in 1935.

Petitioner contended before the Tax Court that the 1935 transaction was one from which no gain or loss was recognizable because of the application of section 112(b) (5) of the Revenue Act of 1934;

that it was a tax free reorganization within the scope of section 112(g)(1)(B) of the Revenue Act of 1934, as amended and therefore petitioner's exchange was exempt from gain or loss under section 112(b)(3) of said Act; and that in any event the transaction came within the [138] scope of section 112(1), as added by section 121 of the Revenue Act of 1943; and that as a result of the application of any of these non-recognition provisions, and of the related basis provision section 113(a)(6) as amended, petitioner's basis for the stock, bonds and note of the old insolvent company carried over as its substituted basis for the securities in the new company.

The Tax Court held that the exchange of bonds and preferred stock of the old company for bonds and stock of the new company came within the scope of either section 112(b)(3) or section 112(1) or both and the basis for the securities so exchanged carried over to the new securities. But the Court held the exchange of the note for new stock was not a tax free exchange and the basis for said note did not carry over. Similarly it was held the relinquishment of the common stock gave rise to a loss in 1935 and the basis therefor was not carried over to the new securities.

#### IV.

#### ASSIGNMENTS OF ERROR

Your petitioner avers that in the record and proceedings before the Tax Court of the United States and the opinion and final decision entered by the



Tax Court of the United States, manifest errors occurred and intervened to [139] the prejudice of your petitioner who now assigns the following errors and each of them which it avers occurred in said record, proceeding, opinion and final decision so rendered and entered by the Tax Court of the United States.

The Tax Court of the United States erred:

1. In holding that the transaction by which petitioner received stock and bonds of California Consumers Corporation in a 77B reorganization in exchange for stock, bonds and a note of a predecessor company, California Consumers Company did not come within the scope of section 112(b)(5) of the Revenue Act of 1934;

2. In holding that the exchange of the note of the California Consumers Company for stock of the new company did not fall within the provisions of section 112(b)(3);

3. In separating a single unified transaction, i.e., said plan of reorganization in 1935, into four separate exchanges, certain of which were held to be tax free and others of which were held subject to the recognition of gain or loss;

4. In holding that petitioner sustained a loss in 1935 on its relinquishment or extinguishment of the common stock of California Consumers Company;

5. In holding that no part of petitioner's original basis for the common stock may be included as

any part of its [140] retained basis for the stock of the new company.

6. In holding that the note of California Consumers Company was not a "security" within the meaning of section 112(b)(3) of the Revenue Act of 1934 and section 112(1) of the Internal Revenue Code as added by section 121 of the Revenue Act of 1943;

7. In holding that the exchange of the note of the California Consumers Company for stock in the new company was not exempt from the recognition of gain or loss under said section 112(1) of the Internal Revenue Code;

8. In holding that the amount of stock and securities of the California Consumers Corporation received by the parties to the reorganization under section 77B (including petitioner) was not substantially in proportion to their respective interest in the insolvent company prior to the exchange; and

9. In that its decision is not supported by the evidence and is contrary to law.

Wherefore, your petitioner petitions that the decision of the Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for [141] the Ninth Circuit; that a transcript of record be prepared in accordance with the law and with the rules of said court and be transmitted to the clerk of said court for filing and that

appropriate action be taken, to the end that the errors complained of may be reviewed by said court.

FELIX T. SMITH,  
SIGVALD NIELSON,  
GRANVILLE S. BORDEN,  
SCOTT C. LAMBERT,

Attorneys for Petitioner on  
Review.

[Endorsed]: T.C.U.S. Filed July 20, 1945. [142]

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[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION  
FOR REVIEW

To: Joseph D. Nunan, Jr., Commissioner of Internal Revenue, Washington, D. C.:

You are hereby notified Pacific Public Service Company did on the 20th day of July, 1945, file with the clerk of the Tax Court of the United States in Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of a decision of the Tax Court heretofore rendered in the above entitled cause. A copy of the petitions on review and the assignments of error as filed is hereto attached and served upon you [143] dated July 20, 1945.

(s) FELIX T. SMITH,  
(s) SIGVALD NIELSON,  
(s) GRANVILLE S. BORDEN,  
(s) SCOTT C. LAMBERT,

Attorneys for Petitioner on  
Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 20th day of July, 1945.

(s) J. P. WENCHEL,  
Attorney for Respondent on  
Review.

[Endorsed]: T.C.U.S. Filed July 20, 1945. [144]

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[Title of Circuit Court of Appeals and Cause.]

#### STATEMENT OF POINTS

Comes now petitioner on review and makes this concise statement of points on which it intends to rely on the review herein, to wit:

The Tax Court of the United States erred:

1. In holding that the transaction by which petitioner received stock and bonds of California Consumers Corporation in a 77B reorganization in exchange for stock, bonds and a note of a predecessor company, California Consumers Company did not come within the scope of section 112 (b) (5) of the Revenue Act of 1934;

2. In holding that the exchange of the note of the California Consumers Company for stock of the new company did not fall within the provisions of section 112 (b) (3);

3. In separating a single unified transaction, i. e., [145] said plan of reorganization in 1935, into four separate exchanges, certain of which were held to be tax free and others of which were held subject to the recognition of gain or loss;

4. In holding that petitioner sustained a loss in 1935 on its relinquishment or extinguishment of the common stock of California Consumers Company;

5. In holding that no part of petitioner's original basis for the common stock may be included as any part of its retained basis for the stock of the new company.

6. In holding that the note of California Consumers Company was not a "security" within the meaning of section 112 (b) (3) of the Revenue Act of 1934 and section 112 (1) of the Internal Revenue Code as added by section 121 of the Revenue Act of 1943;

7. In holding that the exchange of the note of the California Consumers Company for stock in the new company was not exempt from the recognition of gain or loss under said section 112 (1) of the Internal Revenue Code;

8. In holding that the amount of stock and securities of the California Consumers Corporation received by the parties to the reorganization under section 77B (including petitioner) was not substantially in proportion to their respective interests



in the insolvent company prior to the exchange; and [146]

9. In that its decision is not supported by the evidence and is contrary to law.

Wherefore, your petitioner petitions that the decision of the Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of record be prepared in accordance with the law and with the rules of said court and be transmitted to the clerk of said court for filing and that appropriate action be taken, to the end that the errors complained of may be reviewed by said court.

FELIX T. SMITH

SIGVALD NIELSON

GRANVILLE S. BORDEN

SCOTT C. LAMBERT

Attorneys for Petitioner on  
Review

Service of a copy of the above statement of points is acknowledged this 20th day of September 1945.

J. P. WENCHEL, Sly

Chief Counsel, Bureau of Internal Revenue

[Endorsed]: T. C. U. S. Filed Sept. 20, 1945. [147]

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF PORTIONS OF RECORDS,  
PROCEEDINGS AND EVIDENCE TO BE  
CONTAINED IN RECORD ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies, duly certified as correct, of the following documents and records in the above entitled cause, in connection with the petition for review by the said Circuit Court of Appeals, Ninth Circuit, heretofore filed by the Pacific Public Service Company:

1. Docket entries.

2. Pleadings:

(a) Petition, including Exhibit "A" attached thereto, which is a copy of the notice of [148] deficiency.

(b) Answer to petition.

(c) Motion for leave to file [first] amendment to petition.

(d) [First] Amendment to petition.

(d-1) Answer to [First] Amendment to petition.

(e) Motion [by Respondent for leave to amend the answer to the petition by striking subparagraph (B) (9) (c) of paragraph 5 of the answer and substituting therefore the amendment attached thereto.]

(f) Amendment to answer to petition.

(g) Motion to reopen record for admission of

evidence material since the enactment of the Revenue Act of 1943.

(h) Motion for leave to file [second] amendment to petition.

(i) [Second] Amendment to petition.

(j) Answer to [second] amendment to petition.

3. Stipulation of facts (and exhibit 1-a designated in Paragraph 5 below).

4. Transcript of hearing.

5. Exhibit 1-A, plan of reorganization of California Consumers Company (attached to Stipulation of Facts).

6. Respondent's Exhibit A, copy of complaint filed in Superior Court of California against Pacific Public Service Company alleging the illegal [149] declaration and payment of dividends by California Consumers Company.

7. Petitioner's Exhibit 2, certified copy of stipulation indefinitely extending time to bring dividend suit to trial.

8. Supplemental stipulation of facts.

9. The opinion and decision of the Tax Court.

10. The petition for review and assignments of error.

11. The notice of filing the petition for review.

12. The statement of points.

13. The designation of portions of the record to be printed.

14. This designation.

FELIX T. SMITH  
SIGVALD NIELSON  
GRANVILLE S. BORDEN  
SCOTT C. LAMBERT

Attorneys for Petitioner on  
Review

Service of a copy of the above Designation of Portions of Records, Proceedings and Evidence to be Contained in Record on Review is acknowledged this 20th day of September, 1945, and agreed to.

J. P. WENCHEL, Sly,  
Chief Counsel, Bureau of In-  
ternal Revenue

[Endorsed]: T. C. U. S. Filed Sept. 20,  
1945. [150]

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The Tax Court of the United States  
Washington

Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

CERTIFICATE

I, B. D. Gamble, clerk of The Tax Court of the United States do hereby certify that the foregoing

pages, 1 to 150, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 21st day of September, 1945.

(Seal)

B. D. GAMBLE

Clerk, The Tax Court of the  
United States.

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[Endorsed]: No. 11146. United States Circuit Court of Appeals for the Ninth Circuit. Pacific Public Service Company, a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed September 24, 1945.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.



In the United States Circuit Court of Appeals  
For the Ninth Circuit

T. C. Docket No. 2159

PACIFIC PUBLIC SERVICE COMPANY,  
Petitioner on Review,  
vs.

JOSEPH D. NUNAN, JR., Commissioner of Internal Revenue,  
Respondent on Review.

DESIGNATION OF PORTIONS OF THE  
RECORD TO BE PRINTED

Comes now the petitioner on review herein and, complying with the rules of this court pertaining to the designation of the portions of the record to be printed, states that it relies upon the entire record, certified by the Clerk of the Tax Court of the United States to this court, and directs that said record, so certified, be printed as directed on review.

Respectfully submitted,

FELIX T. SMITH

SIGVALD NIELSON

GRANVILLE S. BORDEN

SCOTT C. LAMBERT

Attorneys for Petitioner on  
Review

Service of a copy of the above Designation acknowledged this 19th day of September, 1945.

SAMUEL O. CLARK, Jr.

Assistant Attorney General

[Endorsed]: Filed September 19, 1945. Paul P. O'Brien, Clerk.